A STUDY OF LOCAL GOVERNMENT FINANCIAL REPORTING PRACTICES AND ACCOUNTING PRINCIPLES

by

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This study presents a detailed analysis of local government financial reporting and the accounting principles that guide it. An extensive examination was made of accounting, political science, and public administration literature dealing with local government financial administration and accounting principles. To answer the question of where are we and how we got there, a history of the evolution in thought, practice, and institutions affecting local government accounting is provided. The focus of this aspect of the study is primarily on the historic development of local government financial reporting and applicable accounting principles.

A detailed analysis of recent major studies dealing with governmental financial reporting and accounting is presented. The analysis includes the background, findings, methodology, and critical reaction to the published research of major professional organizations concerned with governmental accounting, including the National Committee on Governmental Accounting, the American

Accounting Association, and the American Indsitute of Certified Public Accountants.

A critical examination is made of actual local government financial reporting practices. The examination includes a detailed review of Georgia local government financial reports and compares these with standards of good practice as set by the Municipal Finance Officers Association and the American Institute of Certified Public Accountants. These findings are then compared with similar studies performed in other areas.

To round out the reader's perspective on the problem area, an analysis is also presented on the possibly unique organizational characteristics of local government and their effects on financial reporting, the major variations between financial reporting in the public and private sector, and the uses and users of local government financial reports.

Based on the study of current reporting practices, a set of descriptive accounting principles was formulated. These principles, if followed, should provide a reasonably effective guide to what is now considered accepted "good" practice.

A major conclusion of the study was that both the principles promulgated by major professional organizations and these descriptive of good practice resulted in financial reports that were primarily effective in determining legal stewardship. The reports would not provide an effective information flow in most cases for organizational planning and

control. Because of the fund structure employed and the varying practices followed, the financial reports tended to present a confusing picture.

Based on the research for this study, a set of "prescriptive" accounting principles was formulated. These principles, if adhered to in local government financial reporting, could significantly improve local government financial reporting. The financial reports could assist local government units in communicating a comprehensive historical picture of the legality, effectiveness, and efficiency of organizational resources applied to meet organizational objectives. An illustrative set of financial reports prepared following these principles is provided.

CHAPTER I

INTRODUCTION

Since World War II drastic domestic changes have occurred in the United States. To many it appears as if the very fabric of American society has been strained to such an extent that a basic reorientation of thinking about our life styles, societal goals, and our basic institutional organizations has become necessary. One basic institution that has been and is coming under drastic environmental stress is our local government system.

> American institutions of local government are under severe and increasing strain. . . . they are poorly suited to cope with new burdens imposed on all governments by the complex condition of modern life. Adaptation to change has been so slow, so limited, and so reluctant that the future role--even the continued viability--of these institutions is now in grave doubt.[1]

Societal expectations of local governments appear to have been modified significantly in recent years. Traditional local government services have been expanded drastically to meet current needs. Demands for new services and functions seem

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[1]Research and Policy Committee of the Committee for Economic Development, Modernizing Local Government (New York: Committee for Economic Development, 1966), p. 8.

to arise daily. "The demands of citizens for increased services, added to the complexity of problems which currently beset urban areas, will enlarge the scope of government at the local levels far beyond the present levels."[2]

The rate of growth of revenues, expenditures, and employment at the local level of government now surpass most other parts of the economy. Table 1 below shows the increase in expenditures experienced by local governments since World War II.

TABLE 1

TOTAL LOCAL GOVERNMENT EXPENDITURES[a]

	(Millions of $)
1942	$ 7,351
1952	30,229
1962	45,279
1967	$66,648

[a]U. S. Bureau of the Census, Census of Governments, 1967, Vol. 6, Topical Studies No. 5: Historical Statistics on Governmental Finances and Employment, (Washington, D. C.: U. S. Government Printing Office, 1969), pp. 45-47.

Present trends appear to indicate that an ever increasing portion of our total resources will be allocated to this sector.

As local governments have grown in size and complexity, the need for improved financial administration and effective financial reporting has also grown. As an editorial in Municipal Finance noted:

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[2]Bruce Joplin. "Local Government Accounting, It's Your Responsibility, Too," Journal of Accountancy, CXXIV (August, 1967), p. 38.

> No government unit now operates in isolation, if it ever did. The strains of an urbanizing society have increased their intensity on intra- and inter-governmental relations lending imperativeness to the needs for improved fiscal management. No longer can any governmental unit afford the luxury of ill conceived, poorly designed and operated accounting systems that result in unintelligible, and disjointed compilations of fiscal data dispensed under a well intentioned but misconceived idea that they will produce a proper financial report.[3]

As we shall explore in greater detail in later chapters, the financial administration and particularly the financial reporting of local governments has serious shortcomings. As one Georgia state senator, who is also a Certified Public Accountant put it,

> Governmental Accounting and financial statement preparation is the most neglected area of the accounting profession . . . governmental financial reporting and the accounting records upon which it is based may be generally described as inadequate throughout Georgia and, in fact, throughout the United States.[4]

From mid-1968 through 1971 the writer has served as consultant on financial administration to local governments for the Institute of Government of the University of Georgia. During this time, as a result of extensive field experience and research, several points became quite evident. Local government financial administration and particularly financial

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[3]Editorial, Municipal Finance, XXLI (February, 1968), p. 110.

[4]James P. Wesberry, "Sound Financial Systems Lacking in Georgia," Georgia Municipal Journal, XVII (March, 1967), p. 14.

reporting to external parties is in a deplorable state. To improve local government financial reporting, a basic step must be to formulate a set of accounting principles applicable to local government financial reporting. As the chairman of an American Institute of Certified Public Accountants committee on accounting for non-profit organizations stated:

> The absence of appropriate reporting principles and standards is leading to increasing confusion and misunderstanding . . . immediate importance of developing appropriate reporting standards in this highly critical area . . . the objective of financial reporting is to present financial data fairly. It is self evident that such data to be fairly presented must be in acceptance with some principles or standards of presentation.[5]

The purpose of this study is

(1) to present a concise picture of the historical development and the primary factors shaping the evolution of local government accounting and its principles;

(2) to review and summarize the major findings of relevant research on accounting principles for local governments;

(3) to prepare an analysis that shows what financial reporting practices and accounting principles are actually followed by local governments;

(4) to depict the serious shortcomings and inadequacies of

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[5]Howard A. Withey, "Financial Reporting for Nonprofit Organizations," Journal of Accountancy, CXXIV (December, 1967), pp. 40-41.

local government financial statements and existing sets of accounting principles; and

(5) to formulate a set of accounting principles that if followed should significantly improve financial reporting in local governments.

This study presents the results of extensive literature research and analysis, as well as considerable field investigation and research on local government financial reporting and accounting principles. In the following paragraphs the goals and scope and methodology utilized in each part of the study are discussed in detail.

In Chapter II a brief history of the evolution in thought, practice, and institutions shaping local government accounting in the United States is provided. The analysis considers changes in the system in response to environmental needs and identifies factors causing change. The goal of the chapter is to provide answers to the questions of where are we and how we got there, and to throw light on the origins of current practices and concepts to provide insight for problem solution. The focus is primarily on historic development of local government financial reporting and applicable accounting principles. Included also in the chapter is a selective review of the development of local governments as functioning organizations to provide the reader with the broader picture necessary to provide proper perspective of the problem area of financial reporting and its applicable principles.

The goal of Chapter III is to provide a review of recent major literature dealing with governmental financial reporting and accounting principles. The review summarizes the programs and published research of the major professional organizations concerned with accounting principles and financial reporting, as well as independent studies. The analysis, insofar as possible, presents the background, findings, methodology and critical reaction for each major study. At the conclusion of the analysis of the individual works a review is made contrasting the methodologies and the findings of the various studies.

The goal of Chapter IV is to present a comprehensive analysis of the actual financial reporting practices of local governments. The analysis is presented in three major segments. The first part of the analysis focuses on local government accounting in the State of Georgia. To provide the reader with an overview of our complex local government structure and the various financial reporting practices, a detailed study of a metropolitan area was made. In the study, numerous interviews were held with state and local officials and extensive examination made of the financial administration structure. The findings of this study are summarized in this work by major organizational unit. In addition to the study of the metropolitan county, a detailed examination was made on a statewide basis of the financial reporting practices of Georgia's cities and counties. In this portion of the study 100 published financial reports were subjected to a detailed analysis and comparison.

The second part of the analysis summarizes the findings of other relevant research on the actual financial accounting practices of local governments. The findings of the Georgia study and the studies in other areas are then summarized and contrasted. In the third part of the analysis a review is made of the regulation of local government financial reporting by state and federal agencies. Local government financial administration and reporting is subject to varying degrees of prescription and regulation. This segment acquaints the reader with the nature and effect of such regulation.

The goal of Chapter V is to round out the reader's perspective on the problem area by a discussion of three areas not included in preceding chapters. The first section of the chapter reviews the possible unique organizational characteristics of local governments and their effects on organizational reporting and financial administration. The second section presents an analysis of the major variations between the system used to report financial data in the private sector and the system used in the public sector. The third section presents a review and analysis of the users and uses of local government financial reports. The chapter concludes with a case study which illustrates the role and importance of financial reporting and accounting principles in local government.

Chapter VI has two major goals. A summary is made of the major findings and conclusions of the previous chapters. In addition two alternative sets of accounting principles for

local governments are presented. The first set is primarily descriptive and for comparative purposes is patterned after those contained in Accounting Research Study No. 7, which are reviewed in Chapter III. The second set of accounting principles presented is prescriptive and pointed toward system improvement.

This study is focused on and keyed to the financial reporting and applicable accounting principles for local government organizations. No attempt has been made to relate the research, findings, or recommendations to either state or federal governments or nonprofit nongovernmental organizations.

This study is also keyed to external financial reports and the accounting principles applicable to the financial statements which make up those reports. The total accounting system has been considered only to the extent that the external financial reporting system is an interrelated segment of this total system.

The findings and recommendation relating to this study as defined may well have application to other than local government organizations and to other segments of the total accounting-information system, such as internal management reporting. This, however, is not included in the scope of this work.

CHAPTER II

EVOLUTION OF LOCAL GOVERNMENT FINANCIAL ACCOUNTING

In this chapter a selected chronological narrative of the evolution of local government financial reporting and accounting principles is presented. Brought to the lens position for examination are selected critical factors which influenced accounting development. The analysis considers such factors affecting development as the evolving organizational characteristics and the changing role of local government as well as such institutional forces as the turn-of-the-century reform groups and the Municipal Finance Officers Association. Together with the analysis presented in later chapters, the goal of this chapter is to show the origin of existing practices and to identify factors that interacted in the change process.

American local governments' foundations reach back through the years to precolonial English origins. Many of our present-day local government offices and institutions had a long history in English local government when they were transplanted almost intact to the colonies. The sheriff, for example, now a county peace officer and court official was originally the chief executive of the pre-Norman shire

court. The English local government system had evolved into counties, boroughs, and townships long before the first colonists settled in the new world.[1]

In the early decades of our country, local government and its administration was rudimentary and the citizens were concerned primarily with getting enough food to eat and a roof over their heads. Although early local governments had judicial, legislative, and executive functions, there generally was no separation of powers. Local government legislative powers were usually limited and consisted primarily of ordinances for maintenance of order and prevention of nuisances. Before the nineteenth century many cities were not even entrusted with the right of taxation. The administrative powers of local government dealt almost exclusively with matters of special community interest.[2]

Between the Revolutionary War and the Civil War, local government was characterized by the forces of democracy, decentralization, and territorial expansion. After the United States became independent, state legislatures were quick to establish their supremacy in local government affairs. Charters were granted directly by state legislatures.

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[1]For an excellent discussion of the origins of American local government see Harold S. Alderfer, American Local Government and Administration (New York: Macmillan Company, 1956), pp. 1-75.

[2]For a summary history of colonial local governments see John A. Fawlie, Municipal Administration (New York: Macmillan Company, 1901), pp. 1-100.

Sufferage restrictions based on property during this period, relating to males, generally were abolished and the concept of government by the common man was established. In many cases where local governments had been ruled by a close corporation in which no popular elections were held, now frequent elections of all officials were considered necessary to keep governments from becoming tyrannical.

From the end of the Civil War until the turn of the century, the country went through a period of unprecedented growth. At the time of the Revolution there had been only twenty-four incorporated municipalities and the largest town was Philadelphia with a population of only 42,000. Only three percent of the population at that time lived in nonrural areas. As late as 1800 there were but thirteen cities in the United States with a population of over 8,000. By the year 1900, however, there were over 545 cities with a population of over 8,000. During the last decade of the nineteenth century the nation's cities grew by more than thirty percent. The 160 largest cities by 1900 contained over a quarter of the country's population.[3]

This half-century following the Civil War is often termed the dark ages of American municipal history.

> The forces released by the democratic wave in the first half of the century, blending with the

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[3]Frank J. Goodnow, Municipal Government (New York: Century Company, 1909), p. 4.

> increasing growth of cities and industry, the waves of new immigrants and the materialism of thought and activity, culminated in unrestrained fury upon American local government.[4]

During this period state legislatures tended to control the more profitable aspects of local government such as utility franchises and patronage. Special local government legislation was so common after 1850 that in some states it took up a majority of the legislatures' time. The "weak mayor" plan was predominant in city government during the last half of the century. Its characteristics included a large council which dominated both legislative and administrative functions, a long ballot with many elected officials, and a mayor with weak administrative powers. Petty local bosses formed political machines that, taking advantage of political partisanship, new immigrants, and a spoils system, brought corruption and financial extravagance to local government.

Both the expenditures and the debt of local governments rose sharply during this period. In New York City, for example, expenditures rose from $3 million in 1850 to $93 million in 1899. To camouflage expenditures public debt was frequently piled up. During the nine-year period from 1866-1875, fifteen of the principal cities had a debt increase of 271 percent.[5]

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[4]Alderfer, American Local Government, p. 72.

[5]Ernest Griffith, The Modern Development of City Government (College Park, Maryland: McGrath Publishing Company, 1969), p. 64.

As with most facets of local government, the procedures for recording and reporting local government financial data were originally based on existing English practices. These early practices evolved through the years as the result of various factors. Through the nineteenth century no discernable pattern emerged for local government financial record keeping and reporting.

> The methods of keeping accounts in the different cities show the extreme of variety and the total lack of anything like a total system . . . in most cases the reports of municipal comptrollers are in such a confused condition that even one well acquainted with the local conditions finds it difficult if not impossible to understand the financial situation.[6]

The New York State Legislature in 1891 made an extensive investigation into the condition of the finances of the state's thirty largest cities. The investigating committee found that most cities could not answer even the simplest questions about their financial condition. The committee declared, "The system of accounting in the several cities is more unintelligible and chaotic even than the laws under which the cities themselves are administered."[7]

The accounting system in most local governments up to the turn of the century was a rudimentary single entry system centered around a cash book.

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[6]Fawlie, Municipal Administration, p. 362.

[7]C. W. Tooke, "Uniformity in Municipal Finance," Municipal Affairs, II (1898), pp. 195-206.

> A form of partial or incomplete accounts was resorted to which would require a statement pertaining to properties and liabilities. . . . Such a system . . . is the system in vogue in nearly all our American cities. This is what may be termed an incomplete method of single-entry accounts, i.e., a system of entries in accounts showing in an incomplete way the single relation--official fidelity or trusteeship.[8]

Although more sophisticated procedures and techniques for financial record keeping were available they were not in general use. Cleveland attributed the slow development of accounting to the predominance of our agrarian economy during the early years of our country's existence.

> Here accounting ideals remained undeveloped long after they had arisen to a basis of scientific classification abroad. Here also financial reports were retained in primitive confusion long after accountancy had become well established as a profession in England and Scotland. This was largely due to the lateness of our national development . . . until the middle of the nineteenth century America was primarily an agricultural community, and the farmer needed no account other than a simple statement of receipts and payments.[9]

Development of accounting in the public sector for many years was paced by development in the private sector. The development of accounting in the private sector in turn responded to demands placed upon it by the environment.

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[8] Fredrick A. Cleveland, Chapters on Municipal Administration and Accounting (New York: Longmans, Green and Co., 1909), p. 108.

[9] Ibid., p. 113.

The turn of the century serves as a significant line of demarcation in local government affairs. Prior to this time local governments were relatively undeveloped, fiscal requirements were small, and the sources of revenue few by today's standards. The process of fiscal administration was simple and any underlying theories were generally regarded as inconsequential. In the beginning of the twentieth century there was a veritable wave of revulsion against the prevailing local government system particularly in the larger cities. This was fanned into flame by "muckrakers" who, writing in popular magazines, brought evidence of corruption to middle-class America. As one critic phrased it, "The municipal government which prevails is needlessly expensive and generally condemned . . . it has caused city administration to be generally regarded as discredited to the American people."[10]

Although earlier reformers had turned their attention to isolated local government problems including financial stringency, the inadequate conditions of local government were not attacked in any practical manner until the turn of the century. The reform movement developed initially through local organizations called by such titles as research bureaus, voter leagues, and taxpayer associations. During the first two decades of the twentieth century, these reform groups

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[10]Dorman Eaton, The Government of Municipalities, (New York: Macmillan Company, 1894), p. 6.

sponsored a number of organizational and procedural changes to improve local government such as direct primary elections and the short ballot.

Out of this reform movement came the first serious attempts in this country to examine and improve local government accounting. Although the local government reform organizations engaged in many activities, the reform of local government systems of financial administration occupied much of their time. "Financial administration has claimed more attention than any other field. The major task of many bureaus has been to work for improved budgeting, accounting, and auditing systems."[11]

The National Municipal League was formed in 1894 to coordinate local reform groups. This organization became the effective and respected leader and symbol of the reform movement. The League was formed with sixteen affiliated organizations but within one year had 180 local member organizations.[12]

The National Municipal League in 1899, after several years of study, published a model state constitutional amendment for local government and a general municipal corporation act. An integral feature of both documents was the

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[11]Norman Gill, Municipal Research Bureaus (Washington: American Council on Public Affairs, 1944), p. 41.

[12]Frank M. Stewart, A Half Century of Municipal Reform, (Berkeley, California: University of California Press, 1950).

requirement that financial reports should be published by all cities on a yearly basis on expenditures, revenues, and debt.[13]

Under the direction of Professor Rowe of the University of Pennsylvania, supporting model financial statements were prepared and published by the League. Appendix IA shows the Summarized Statement of Receipts and Expenditures that was recommended. In more detailed supplementary statements, expenditures were to be classified as follows:

I. Current expenses and maintenance:

1. Salaries
2. Supplies
3. Other Expenses

II. Construction

III. Extraordinary expenditures other than construction.

Little emphasis was placed on the balance sheet in early writings. As illustrated in Appendix IB, a General Statement of Assets and Liabilities was recommended.

The League pushed heavily for uniformity in financial reporting between comparable units. Numerous articles were published on the importance of uniformity in effective use of financial statements.

> The desirability of prescribing uniformity in city reports is so obvious as to require but brief consideration. It is quite likely that this provision

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[13] L. S. Rowe, "Public Accounting Under the Proposed Municipal Programs," Proceedings of the National Municipal League - 1899 (Philadelphia: National Municipal League, 1899), pp. 104-06.

> will prove to be the first step toward a well organized system of central administrative control.[14]

> Intelligible reports are not enough. Our final study of municipal finance must be comparative . . . we must have many financial statements arranged with such identity of plan that they can be compared.[15]

Effective interunit comparison of local government financial statements still remains a problem area today. Devising an effective system to make comparison possible has proved to be much more difficult than originally anticipated. Trying to persuade local government officials to adopt a uniform accounting system proved especially difficult.

> It was found each official was satisfied with his system whether it possesses meaning to others, or was intelligible only to himself; and that he looked upon any inquiry from outside as wholly foreign to the importance of his work.[16]

The above statement was written in 1899 but it could just as well have been yesterday.

The reformers also stressed importance of submitting the annual financial reports to a state official. They looked upon this as a monitoring device that would insure that local financial reports would meet statewide standards.

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[14] Ibid., p. 109.

[15] Fredrick Clow, "Suggestions for the Study of Municipal Finance," Quarterly Journal of Economics, II (July, 1896), p. 461.

[16] Samuel Sparling, "The Importance of Uniformity for Purposes of Comparison," Proceedings of the National Municipal League - 1899, (Philadelphia: National Municipal League, 1901), p. 137.

In 1901 the National Municipal League appointed a Committee on Uniform Municipal Accounting and Statistics. The twelve members of the committee, ranging from an Associate Editor of Engineering News to Wyoming's State Examiner of Accounts, were instructed to prepare and report to the League "such methods or systems for municipal accounts and the collection of municipal statistics as it may find to be most desirable."[17] The Committee presented their report a year later after holding a number of meetings. The Committee noted in their report that

> We have adopted the point of view of a central authority charged, firstly, with the duty of securing strictly uniform reports by means of prescribed forms or blanks, from all cities within our jurisdiction, and secondly, with using such reports as the data for our own report to the Legislature.[18]

The Committee noted that its purpose was to devise a practicable scheme for summarizing the accounts for a "model comptroller's report" and not to elaborate a bookkeeping system. The model reports recommended by the committee were very similar to those proposed by Rowe several years earlier. Perhaps their most interesting feature is the summary shown

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[17] Edwin M. Hartwell, "Report of the Committee on Uniform Municipal Accounting," Proceedings of the National Municipal League - 1901, (Philadelphia: National Municipal League, 1901), p. 249.

[18] Edward Hartwell, "Report of the Committee on Uniform Municipal Accounting and Statistics," Proceedings of the National Municipal League - 1902 (Philadelphia: National Municipal League, 1902), p. 299.

in Appendix IC. The primary emphasis of the report was on providing more detailed breakdowns of revenue and expenditures. The committee had also been charged with a program to bring uniformity to municipal statistics. The Committee found the field of municipal statistics so complicated that they deemed it impracticable to make recommendations.

Members of the National Municipal League actively promoted reform in local government accounting. They wrote and spoke widely on the subject area. They secured adoption of the model financial schedules proposed by the League in eight cities including Boston, Chicago, and Baltimore. They also succeeded in securing legislative reform in a number of states. New York, for example, passed an act requiring third class cities to report annually to the Secretary of State upon uniform blanks based upon the model financial statements prepared by the National Municipal League.

Prior to the turn of the century, the Federal government had neither collected nor reported financial data on local governments on an appreciable scale. In the 1880 census, a comparative exhibit showing assessed value, true value and ad valorem taxes on real property for major local government units was published. The census coverage was broadened in the 1890 census to include a presentation of receipts and payments of states, counties, and some minor local units.

A movement was started in 1897 by Dr. W. R. Maltbie, when editor of Municipal Affairs, to have the Federal government publish a wide range of comprehensive municipal financial

statistics. This movement resulted in 1899 in the passage of a special act of Congress which authorized the Department of Labor to make an annual collection and presentation of social and financial statistics of cities with over 30,000 inhabitants. This function was transferred to the Bureau of the Census in 1902. Initial government efforts in the data gathering of local government finances were directed by Le Grand Powers, the chief statistician for finance and municipal statistics. Powers had been closely associated with the efforts of the National Municipal League to secure uniform account classification and, if one can believe contemporary writings, pursued his work with considerable zeal. Powers was convinced the road to successful reform led through comparable inter-unit financial data. The following quotation reveals something of the fervor with which he pursued his task.

> Keynote of reformation . . . marriage of efficiency to moral excellence in governmental as in private business. To secure this governmental efficiency, accounts will, by force of events--the logic of history--be made uniform, as the measure and test and aid of efficiency of administration . . . Here the Stars are fighting against every Sisera of corruption and of sloth; here we have the promise of that through regeneration of accounts to the needs of which our officials have been convicted and in a large degree been converted.[19]

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[19]Le Grand Powers, "The Bureau of the Census as an Agent of Municipal Reform," Proceedings of the National Municipal League - 1908 (Philadelphia: National Municipal League, 1905), p. 336.

The Bureau of Census had initially sought to use printed reports as prepared by the local units as a basis for the financial data they collected. They soon found this unacceptable because of the diverse methods of accounting, varying classifications of accounts, and the differing organizational structures. The Bureau found that, not only was financial data not comparable between units, in many cases the data was not comparable between years of the same unit. In the Financial Statistics of Cities printed by the Bureau in 1911, seven pages were devoted to the problems they encountered in compiling comparable data. These included the methods of classifications, methods of accounting for indepartmental expenses, differences in organizational structure, and differences in fund structure.[20] The Census Bureau prepared a guidebook on financial reporting based upon the reforms recommended by the National Municipal League. Bureau agents armed with the guidebook were sent into the field to gather, correct, and supplement the published financial reports of local governments. "In the great majority of cities the agents of the Bureau of the Census have been obliged to scrutinize practically every entry of the published financial reports and trace them to ledger accounts."[21] By the turn of the century there were 158

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[20] U. S. Bureau of Census, Financial Statistics of Cities: 1911 (Washington, U. S. Government Printing Office, 1911), pp. 21-27.

[21] Le Grand Powers, "Uniform Accounting in its Relation to Comparative Municipal Statistics," Proceedings of the National Municipal League - 1904 (Philadelphia: National Municipal League, 1904), p. 255.

cities over 30,000 population. (There are now over 600.) Sending agents to each city has become increasingly expensive and today most of the data is gathered by mail and in most cases once every five years.

Throughout the years the Census Bureau has aimed primarily at collecting data on revenues and expenditures and generally has made no attempt to present complete balance sheet summaries. The impact of the Bureau is difficult to measure. They played an educational role in larger cities and were successful in popularizing common financial terminology. They have not, even to date, been successful in obtaining comparable inter-unit local government financial data that can be used effectively for comparative analysis.

In the Proceedings of the National Municipal League - 1904, the members of the municipal finance committee turned their attention for the first time to "principles of local government accounting." Cleveland of New York University wrote:

> A system of accounts must take its form and character from the form and character of functions exercised and as such would result in similar financial reports in the various cities.
>
> To supply the data essential to intelligent judgement a complete double entry system of accounts is necessary rather than the then commonly used single entry system.
>
> A proper classification of accounts required properties intended for continued use be segregated and set apart from assets to which the city may look as a means of payment, and that the current liabilities be distinguished from long-term liabilities.

> From the point of view of official fidelity, a statement of "receipts" and "disbursements" should be made which will reflect the transactions pertaining to and the final condition of each fund kept.[22]

Cleveland expanded on his concepts in an article published the following year. In this article he stated:

> municipal accounting should be a scientific system where the classification of accounts is related to the problems of municipal management and control and the information necessary for solution.[23]

Powers, writing at this time, called upon "friends of uniform accounting and those who desire comparable municipal statistics of fiscal operations to enter upon a new field, namely, the discussion of the principles that should underlie all municipal accounting."[24]

Although no comprehensive, generally accepted set of local government accounting principles directly resulted from the reform movement, the importance of the reformers efforts should not be underestimated. The movement did turn the spotlight of public opinion on local government accounting, its weaknesses and the need for improvement.

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[22] Fredrick A. Cleveland, "What Constitutes Reasonable Uniformity in Municipal Accounts and Reports," Proceedings of the National Municipal League - 1904 (Philadelphia: National Municipal League, 1904), pp. 203-15.

[23] Fredrick A. Cleveland, "The Nomenclature and Phraseology of Municipal Administration and Accounts,"" Proceedings of the National Municipal League - 1905 (Philadelphia: National Municipal League, 1905), pp. 235-43.

[24] Powers, "Uniform Accounting," p. 239.

During this turn-of-the-century period a number of concepts and beliefs were formulated and accepted that still affect the role and function of local government accounting today. The prime movers of the reform movement in most cases were prominent businessmen. From these reformers grew the idea that the principles of "efficient business management" could and should be applied to local government.

> He (the reforming businessman) viewed the structure of the private corporation and the business methods of the nineteenth century with pride and respect. He made famous the assertion . . . that running a city is simply a matter of applying the "principles of good business management."[25]

This belief is very popular even today and many local government candidates campaign under the banner of running the government like a business. A concomitant of this belief is that as a profit-making organization to function effectively requires an adequate accounting system such is also the case for public organizations.

A second belief that arose was that for democratic government to function effectively at local levels there must be an adequate flow of financial information between the local government and its citizens.

> It (the public) must also provide itself with the means of exercising intelligent supervision over

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[25]Charles R. Adrian and Charles Press, Governing Urban America, (3rd ed.; New York: McGraw-Hill Book Company, 1960), p. 82.

> the administrative acts of its representatives and agents . . . The prayer of despairing reform crying in the darkness lacks one essential plea, "Let there be light"--the light that may be shed by a better devised system of public accounts and by regular and accurate reports.[26]

This is a form of rational man argument. What John Doe really needs to turn the rascals out and to make "good" political decisions is adequate and reliable information. Information that can and should be supplied by public financial reports.

A third concept that germinated in this era was the need for a basic refocusing of the purposes of local government accounting. Until this time, financial reporting was aimed primarily at keeping public officials honest. "The old accounting of American cities was conducted with one principal or primary objective--that of showing that the treasurer had not stolen any money."[27] Reformers advocated that the local government accounting system be so designed that it also provide decision-making information for both citizens and public officials.

> Annual reports of cities would give . . . cost, character, and efficiency of their governments . . . great value for preventing and exposing abuses . . . would supply authentic and invaluable facts for intelligent legislation.[28]

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[26]Cleveland, Chapters, pp. 102-04.

[27]Powers, "The Bureau of the Census," p. 309.

[28]Eaton, The Government, p. 52.

This idea too has persisted and professional literature is still occupied with extending the boundaries of local government accounting beyond current practices.

After the turn of the century, the rising spirit of humanitarianism fostered by the Spanish American War proved a powerful influence in expanding local government into new service areas such as recreation, probation, public libraries, and public health. The fight against corruption was strengthened by the accession of Theodore Roosevelt to the Presidency. He proved to be a leader who dominated American life and thought, and strengthened the reform movement. The drive for change fostered by the reform movement translated itself into new forms of local government structure. The weak mayor form proved to be generally inadequate for the busy expanding American, twentieth century municipality.

In 1900 Galveston, Texas, experienced a great flood and tidal wave. In the emergency, a city government patterned on the order of a modern business corporation was created. Municipal power in the commission form of government was concentrated in the hands of a five-man council. This form of government maintained preeminence for some fifteen years during which time some 500 cities adopted the plan. In the end, however, it proved impossible to translate the organizational structure of industry into local government. Commissioners elected on the basis of factors other than administrative skills proved ill equipped to administer municipal governments of increasing size and complexity. "Its ultimate demise was

caused by the realization that the entire system was based upon a faulty institutional premise."[29]

The next evolutional step in local government structure was the addition of a full-time professional administrator to act as manager. The first city to hire a city manager was Staunton, Virginia, in 1908. By 1923 over 300 cities had adopted the city manager plan, and as of January 1, 1969, 2,153 cities and counties in the United States had city managers.[30]

Although World War I caused most local governments to mark time for a short period of time, particularly in the public works field, the first decades of the twentieth century saw a gradual expansion of local governments. The continued national prosperity led to increases in local government credit, confidence in the undertaking of new projects, and the opening of new areas of local government service.

The seeds of change sown by the reform movement fell on fertile ground in the field of local government financial administration. The reform groups had been primarily interested in promoting a system that would result in financial reports showing detailed expenses and revenues that would be comparable between units. Practitioners and "theoreticians"

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[29]Marlenus Nijhoff, Local Government in the United States (Hague: International Union of Local Authorities, 1961), p. 25.

[30]Municipal Year Book - 1969 (Washington: The International City Management Association, 1969), p. 467.

in the following decades changed the emphasis considerably. Texts on government accounting emphasized the pitfalls of following accounting practices of the private sector.

> It has often been arbitrarily and, I believe, incorrectly assumed that the procedure commonly followed in accounts of private business can be applied without material modification to public accounts. As a result I believe that many errors of principle have been committed.[31]

Emphasis was placed on the development of the details of a relatively complicated fund structure. Less attention was given to statements of operations (revenues and expenditures) and more to the previously neglected balance sheet.[32] Emphasis of changes for "improvement" gradually took the form of changes that made local government accounting into a differentiated and complicated subfield of accounting.

Publications on local government accounting during this period were generally limited to providing detailed descriptions of forms and procedures. Little emphasis was directed toward development of local government accounting standards or principles. There were of course exceptions. Lloyd Morey in 1927 wrote:

> To summarize it is my opinion that the accounts and statements of governments and public institutions

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[31]Lloyd Morey, Manual of Municipal Accounting (New York: John Wiley and Sons, Inc., 1927), p. 151.

[32]See for example R. G. Walker, "The Municipal Balance Sheet," Journal of Accountancy, XXXV, No. 3, March 1923, pp. 186-201.

should be maintained in accordance with the following principles:

(1) All accounts should be classified by funds and no consolidation of accounts should be made which does not clearly set forth the resources, obligations, and surplus of each fund in detail.

(2) That the distinction between "proprietary" and "budgetary" accounts should be disregarded and that the accounts of each fund should be unified for all purposes.

(3) That accounts of depreciation, deferred items, and accrued items not actually due, should ordinarily be omitted.

(4) That accounts of fixed assets and liabilities should be maintained and that they should not appear in connection with accounts of funds unless they clearly represent resources or obligations of those funds.[32]

Another widely circulated effort was that published by the Detroit Bureau of Governmental Research. They prepared and published a set of "Standards for the Administration of City Finances" which included the following:

V. Controlling Financial Transactions

1. Accounts should be centralized in the controller's office.
2. Municipal accounting should be maintained on an accrual basis.
3. Controlled inventories of the city's supplies, materials, equipment, and real estate should be maintained.
4. Unit and job costs of city services should be available.
5. Payrolls should be under complete control.
6. All accounts of the city should be audited continuously or periodically by auditing

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[32]Morey, Manual, p. 159.

authority independent of the controller's office.

7. Periodic reports to be made to the public include a complete operating statement and balance sheet.
8. An operation audit is fully as important as a cash audit.[34]

These two publications are noteworthy because of their influence on later publications of the Municipal Finance Officer's Association.[35]

The worst depression in the history of the United States began in the fall of 1929 and did not actually end until the country began to prepare for war a decade later. The general economic conditions during this decade influenced local government financial administration in several ways. There was a great decline in the support of local government reform organizations. The lack of financial support together with the realignments of governmental functions and incursion into the field by universities and governmental bodies contributed to the general demise of most reform groups. The resources and legal authority of local governments proved in most cases inadequate to handle the social problems resulting from the depression. Many local governments had been supported by a tax base that had been deceivingly inflated by a now collapsing real estate boom. In the 1930s many cities found themselves

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[34]Lent D. Upson and C. E. Righter, "Standards of Financial Administrators," National Municipal Review, XVII (February, 1928), pp. 119-132.

[35]For an example of the type of financial statements being recommended in this period see Appendix I-D.

unable to meet not only the continuing costs of operation but public indebtedness for capital projects started in the optimistic 1920s and the ever swelling public relief rolls. Federal and state governments were forced to provide financial relief for the hard pressed local units. Since this period intergovernmental funding and the associated accounting control implications have continually increased. The environmental stress of the 1930s created heavy pressure for change in local government accounting.

> Municipalities need help in solving their financial problems . . . Their debts are heavy and their revenues uncertain. Loose talk about excess governmental expenditures goes unchallenged . . . Definite principles and standards of practice in the municipal accounting field have been sadly lacking.[36]

The banner of improvement in local government accounting was next unfurled not by reform businessmen but by those internal to the system, the Municipal Finance Officers Association. In 1934 they sponsored an organization called the National Committee on Municipal Accounting. At their request ten national organizations (American Association of University Instructors in Accounting, American Institute of Accountants, American Municipal Association, American Society of Certified Public Accountants, International City Managers Association, Municipal Finance Officers Association of the United States

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[36]Carl H. Chatters, "How Accountants Can Serve Municipalities," Journal of Accountancy, LIX (January, 1935), pp. 42-43.

and Canada, National Association of Cost Accountants, National Association of State Auditors, Comptrollers and Treasurers, National Municipal League, United States Bureau of Census) each formed a Municipal Accounting Committee. The chairman of each of these advisory committees automatically became a member of the National Committee. The work effort was accomplished primarily through an executive committee which included the Director of the Municipal Finance Officers Association, Carl Chatters, Irving Tenner then a staff accountant for the organization, and Lloyd Morey of the University of Illinois. These men fairly well dominated the pronouncements of the organizations for many years.

The organization's aims were stated as follows:

(1) To set up principles and standards of municipal accounting;

(2) To develop standard classifications and uniform terminology for accountants and reports;

(3) To embark on an educational campaign to sell these principles and standards to governmental fiscal and accounting officers, so that they may adopt them.[37]

The National Committee published three monographs during 1934, the first year of its inception: A Tentative Outline--Principles of Municipal Accounting (January 1934); Tentative Outline of a Suggested Procedure for a Detailed Municipal

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[37]Joseph M. Lowery, "The National Committee on Governmental Accounting," Municipal Finance XXIII (February, 1951), p. 121.

Audit (May 1934); and A Bibliography of Municipal Accounting (May, 1934). Most significant was the list of municipal government accounting principles. This was the "first effort on a national scale to establish principles of municipal accounting and actively promote their use."[38] These principles which are discussed on the following pages are summarized in Appendix IIA.

The first principle called for centralization of accounts under the direction of one officer who would be made responsible for keeping of all financial records and preparing all financial reports. The Committee stated that while the first principle was not strictly an accounting principle it was an essential organizational feature. They also recommended that the selection of the finance official be made on the basis of merit and that adequate salary scales and reasonable tenure be provided. The second principle called for a double entry bookkeeping system, classification of accounts by fund groups, and a separation of the equity in capital assets from current surplus. The third principle spelled out a fund classification system (general, special revenue, utility, bond, special assessment, trust and pension, agency sinking). The fourth, fifth, and sixth principles called for an integration of budgetary and operational accounts including revenues, expenditures, appropriations, and encumbrances. Revenues and

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[38]Carl H. Chatters, "Principles of Municipal Accounting," Public Management XVI (January, 1934), p. 41.

expenditures were to be properly and consistently classified by proper fund and classification. The seventh principle called for establishment of a cost system which would enable costs to be allocated to the various activities by department. The eighth principle called for development of a subsidiary record system for both consumable and permanent property that could be controlled through the general ledger. Assets were to be recorded at cost of acquisition. The ninth principle called for the accounting of municipal enterprises such as utilities to be handled in a manner similar to that employed by private enterprises. The Committee in initial publications skirted controversial areas and left it optional as to whether accrual or cash accounting was adopted or depreciation taken on capital assets. The principles as published reflected no startling innovation as most had been published in one form or another by authors in the late 1920s.

The National Committee in 1935 expanded on their original publications with the publication of Municipal Funds and Their Balance Sheets. This publication increased the number of accounting principles to fifteen. The revised principles are shown in Appendix IIB. The original principles were included, some in more concise language, and a number of other principles added, including recommendations that the accrual basis in accounting for revenues and expenditures be followed insofar as practical, that financial reports should be prepared monthly or oftener, and that a periodic audit be made by public accountants. The publication also recommended that separate

balance sheets with proprietary and budgetary accounts be prepared for each fund and generally recommended against use of consolidated financial statements. Illustrations of recommended balance sheet formats were included and a copy of the recommended balance sheet for the General Fund is shown on Appendix IE. Compare this Balance Sheet with the simple statement of Assets and Liabilities recommended by the National Municipal League (Appendix IB) and the reader will have some idea of how far the financial reports had evolved into a complicated subfield.

During the next several decades the National Committee issued a number of bulletins on terminology, audit procedure, and accounting statements. No significant changes in recommended accounting principles were made in these bulletins.[39] The next major efforts of the National Committee were started in 1948 when the president of the Municipal Finance Officers Association reactivated the organization which was to be renamed the National Committee on Governmental Accounting. The supporting organizations were again asked to appoint municipal accounting committees. Each advisory committee was requested to review the existing bulletins and submit criticisms and recommendations. This effort resulted in the publication of the well known "Blue Book" (Municipal Accounting and Auditing, 1951) and "RedBook" (Standard Classification of

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[39]The revised set of principles as published in Bulletin No. 12, 1941, is included in Appendix IIC.

Municipal Accounts, 1953). The drafts of both publications were prepared by Irving Tenner, the Committee's consultant. These two publications became the standard reference text for many local government finance officers throughout the 1950s and 1960s.

In Municipal Accounting and Auditing a revised set of principles for local government accounting was published. In the 1951 publication, what had been in prior publications termed principles was now subdivided into two categories: principles and procedures. The principles in the 1935 publication were all included in the revision of 1951, in most cases, verbatim. In addition, principles emphasizing the importance of the effect of legal provisions, cautioning against establishing too many funds, and recommending that common terminology and classification should be used throughout the entire accounting system were added. The Committee attempted to clarify its position on combined fund balance sheets which it recommended rather than consolidated statements. Only minor changes were made in recommended model statements such as revisions in columnar headings or terminology modifications (such as dropping the term reserve). A summary of the accounting principles and procedures as published in Municipal Accounting and Auditing are included in Appendix IID, and a sample balance sheet in Appendix IF.

The Committee's 1953 publication, A Standard Classification of Municipal Accounts, was "designed to serve as a basis for both administrative control and the compilation of financial

statistics . . . to all municipalities or other local governmental units irrespective of their size, activity, structure, or system of accounting."[40] The publication provided detailed explanations of balance sheet, revenue, and expenditure accounts. Previous editions had omitted balance sheet accounts. In the case of account categories that had previously been published the outdated accounts were eliminated, new accounts added, and the explanations amplified.

The unsettling period of the Great Depression was followed by World War II. Since these events local governments have been struggling to find a contemporary niche. While local governments have not ceased to be decision makers, in most cases they must now share important decisions. The trend has and continues to be toward a blending of its responsibilities, financing, and control with those of state and federal governments, particularly in the area of human resources.

A British political scientist at the turn of the century termed the government of American cities our one conspicuous failure. Adrian notes that though the statement was made 65 years ago many Americans believe it appropriate today.[41] Local governments today are plagued with a multitude of significant problems. The population of our urban areas doubled between

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[40]Irving Tenner, "Revised Classification of Accounts," Municipal Finance, XXV (February, 1953), p. 106.

[41]Adrian and Press, Governing Urban America, p. 2.

the Civil War and the turn of the century, but it took only 25 years for it to double again. By 1960, 70 percent of the population of the United States was living in urban areas and the number continues to climb. While urban areas have been increasing in population, the central core city has declined and become increasingly the home of the economically disadvantaged. Central cities have been faced with enormous problems in the fields of crime, health, education, transportation, and welfare. Local governments have been forced to expand traditional programs and add new ones much faster than relatively inelastic sources of revenue generally permit. Continuing the trend of the 1930s state and federal agencies have increasingly played a major role in financing and administration of "local" public service programs.

Summary

The review of the historical development of local government accounting and financial reporting provides considerable insight into the factors affecting its evolution. In tracing the development, an attempt was also made to include events, personages, and publications that affected local governments and their accounting systems.

Adherence to existing tradition has been a significant factor affecting the development of local government accounting. American local government structure is deeply rooted in the past. As with most facets of local government, the accounting function was originally based on the concepts and practices

transplanted with the English colonists. Some of these concepts and practices have persisted in local governments even through today. In many rural Georgia counties, time appears to have washed over the courthouse causing no more than a ripple of change. Initially the accounting function had a "system" only in the broadest sense. As still exists in some places, post-colonial accounting consisted primarily of nonintegrated record sets of who still owed and who had paid their property tax, and a listing of cash disbursements by warrant. Financial reporting in a formal sense was minimal. As long as units consumed few resources and remained relatively small in size, oral reporting at town meetings and similar techniques were satisfactory.

Thus simplistic financial systems persisted for what appears to have been a remarkably long time. In view of the lessons of history this is not surprising. The use of notched elmwood splints called tallies persisted as an integral part of the English government finance system until 1826; centuries after they had outlived their usefulness.[42]

Until the turn of the century, the United States was primarily an agricultural nation. The accounting system in the private sector of this country had not evolved as fast as it had in more industrialized nations. This and the adherence to traditional methods contributed significantly to an initial

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[42]Rudolph Robert, "A Short History of Tallies," Accounting Research, III (July, 1952), pp. 220-229.

lack of development in governmental accounting. Until the rapid growth of the public sector in recent years, the relative state of development of accounting in the private sector seems to have been a pacing factor on change in the system utilized in the public sector. As the nation became more industrialized in the post-Civil-War years, accounting in the private sector developed to meet demands placed on it. After the turn of the century, many businessmen were urging local governments to adopt the "proven" accounting techniques of business. With the expansion of the public sector in recent decades and particularly the last ten years, this appears to have become less of a factor. Attention has now been turned to independent development of information-accounting systems designed especially for needs of the public sector.

Although for many of the smaller units the simplistic cash basic accounting system continued to serve organizational needs, such was not the case in our larger cities. In the nation's fast growing metropolitan areas, the inadequacies of the financial-reporting system was assigned a significant share of the blame for the gross financial mismanagement which occurred between the Civil War and the turn of the century. The pressure of organizational needs working primarily through reform groups created the impetus for change. The changing needs of public organizations and those who administer them, throughout the years, have continued to be a primary factor in movements for change in the local government accounting-reporting

system. This has been most evident in growing metropolitan areas where demands on local governments have been greatest.

The turn of the century local government reform groups played a significant role in the evolution of local government accounting. Primarily the reformers were critics external to the system. They saw improvements in financial reporting as a necessary ingredient in an improved system of accountability for local government organizations. The reformers rather than achieving the widespread change they had envisioned acted more in the role of catalysts. They served in some measure to hold shortcomings of the financial system up to public scrutiny. They helped clarify the importance of the role that accounting-financial reporting could play in local government. They proposed alternate solutions to the status quo, and they worked at securing legislative approval of improved mandated systems.

That they did not have more measurable success in their primary goal of securing local government financial data of interunit comparability is not surprising. The practicing members of an organization are invariably slow to adopt suggestions of "well-meaning" outsiders. As in many such instances, the reformers overlooked important points necessary for the system change. The proposed change overlooked the necessary detailed mechanics for implementation of the broad "improved" system. The proposed reporting and necessary existing housekeeping (payroll, billpaying, tax record) functions were not successfully integrated. The uncertainties of the changes

proposed were not dispelled sufficiently through training to overcome resistance to revising the status quo by those actually employed in record keeping.

The efforts of the Municipal Finance Officers Association have played a major role in the evolution of local government accounting since the 1930s. The Association has undoubtedly been motivated by several factors to engage in the role they have played. The desire for self-policing is an evident factor. From the standpoint of those operating the system, who is best suited to determine system principles, obviously peer group members. As with most organizations of similar composition, there has been the desire to achieve professional status with its attendant economic benefits. In any list of musts for professional organizations, "approved principles" for major functions, and official publications promulgating good practices, have high places of priority.

Viewed in retrospect the prescribed system changes by the Association have been relatively minor. The pressure for change has been satisfied with periodic official issuances that have in a large part been dominated by a few of the older members. There has of course been some change. The principles of governmental accounting as recommended by the official publications have gradually evolved from general rules for the financial system to rules for financial reporting. On major problem areas, such as depreciation of fixed assets and the basis of accounting, the principles have firmed from original positions

of ambivalence to that of creation of unique detailed prescription. Separate report sets and journalizing are now set forth by fund and prescriptions made for historic problem areas such as long-term debt and interfund transactions. The net effect of the Association's recommendations has been to gradually increase the differentiation between the financial reporting in public and private organizations.

CHAPTER III

CURRENT LOCAL GOVERNMENT ACCOUNTING LITERATURE

During the last decade increasing attention has been turned to the formulation of sets of principles that if followed would improve financial reporting. The major professional organizations have engaged in research programs aimed directly at formulating accounting principles that would become generally accepted. This chapter reviews the major publications issued in the last ten years dealing with the problem area of local government financial reporting and accounting principles. The various authors have attacked the problem area in a number of different ways, have arrived at varying conclusions, and have experienced differing degrees of approval from peer groups. In reviewing the major publications, the writer has not only attempted to summarize their findings but to provide sufficient background on each study so that it can properly be evaluated in regard to its contribution to problem solution.

The first work to be reviewed is the latest publication of the National Committee on Governmental Accounting. In 1968 the National Committee issued Governmental Accounting, Auditing, and Financial Reporting.[1] Our analysis here will continue the

[1]National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago: Municipal Finance Officers Association, 1968).

examination, started in the previous chapter, of the National Committee's efforts at establishing standards of "good" practice.

The American Accounting Association has two related publications which deserve consideration in this study. The first is a 1966 publication, A Statement of Basic Accounting Theory.[2] In this publication a research committee of the Association determined standards for accounting information and guidelines for communicating information. Upon completion of this effort, work was then started by another study group to evaluate accounting practices of not-for-profit organizations in the light of these standards and guidelines. This effort was completed and published in 1971.[3]

In 1965 a research study was completed by the American Institute of Certified Public Accountants which inventoried "generally accepted" accounting principles in business enterprises.[4] This work probably is the most complete listing compiled to date of principles, of what practitioners consider

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[2]American Accounting Association, A Statement of Basic Accounting Theory (Evanson, Illinois: American Accounting Association, 1966).

[3]American Accounting Association Committee on Accounting Practices of Not-for-Profit Organizations, "Report on the Committee of Accounting Practices of Not-for-Profit Organizations," Accounting Review XLVI (Supplement 1971), pp. 80-162.

[4]Paul Grady, "Inventory of Generally Accepted Accounting Principles for Business Enterprises," Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965).

good practice, in the private sector. The contrast between this work and that of the National Committee is particularly noteworthy.

The final major work to be reviewed is a study by Emerson Henke, a Baylor professor. This is a major study which was privately financed. The study was published by Indiana University in 1965. It was intended to serve as a review and analysis of financial reporting problems of non-profit organizations.[5]

A summary analysis is presented at the end of the chapter to provide a review of significant points and similar and varying methodologies and findings.

Governmental Accounting, Auditing, and Financial Reporting

This publication originally started out to be an updating of the National Committee's 1951 publication, Municipal Accounting and Auditing and the 1953 publication, A Standard Classification of Municipal Accounts. The final effort proved much more time consuming and was more comprehensive than originally planned.

In previous National Committee efforts a staff member of the Municipal Finance Officers Association had prepared drafts; in this effort two University of Texas professors, Lynn J. Anderson and Frank D. Graydon, served as the project consultants.

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[5]Emerson Henke, Accounting for Nonprofit Organizations: An Exploratory Study (Bloomington, Indiana: Indiana University Bureau of Business Research of Graduate School of Business, 1965).

Graydon served as a consultant on that part of the project which involved revision of basic accounting principles and practices. Anderson conducted the remainder of the research and prepared the original and revised drafts.

As in previous National Committee publication efforts, advisory committees were formed by major national accounting and governmental organizations, the chairman of each advisory committee automatically became a member of the National Committee on Governmental Accounting. As in previous efforts an overwhelming majority of the National Committee were present or former governmental accounting officers.

The advisory committees served as a sounding board for the consultants' drafts. "Considerable draft material was reviewed by members of this Committee (National Committee) and the several Advisory Committees who submitted valuable comments and suggestions during the course of the revision project."[6] Lowery noted the following regarding AICPA participation:

> Not only did the chairman of the American Institute of Certified Public Accountants Advisory Committee participate in the deliberations of the National Committee, but two of his committee members were completely involved at all times.[7]

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[6]National Committee on Governmental Accounting, Governmental Accounting

[7]Joseph M. Lowery, "Governmental Accounting, Auditing and Financial Reporting," Municipal Finance, XL (February, 1968), p. 114.

The final draft was approved only by the Executive Committee, however, and not by the entire fifteen-man National Committee. The Executive Committee consisted of:

> Joseph Lowery - Ernst and Ernst Manager and former (30 years) Auditor-Controller of Los Angeles County
>
> Joseph Cunningham - former First Deputy Comptroller of the City of New York
>
> T. Leroy Martin - Northwestern University

Lowery had served on the Executive Committee for the 1951 publication efforts. All of the Executive Committee were well over 60 years old, and had long been associated with the Municipal Finance Officers accounting publications efforts.

The publication published in 1968 in final form is not officially endorsed by the member organizations. The AICPA noted the following in an editorial:

> Several members have asked whether the American Institute of CPAs has endorsed this new publication. Their inquiries are based on the fact that an AICPA advisory committee is listed among the many advisory committees which assisted in the preparation of the book by reviewing draft material and offering suggestions. The assistance given to the National Committee does not constitute an official endorsement of the book by the Institute. The advisory committee made numerous suggestions, some of which were accepted and some rejected. The committee did not take a position on the final document, but was purely advisory.[8]

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[8] Editorial, Journal of Accountancy, CXXVI (July, 1968), p. 67.

The 1968 publication was considerably different in format from previous National Committee efforts. A separate chapter was devoted to governmental accounting principles. The principle was stated and then explanatory material was provided for clarification. Separate chapters were devoted to each fund with sample entries and financial statements provided. Individual chapters also were included on financial reporting, statistical tables and auditing of governmental units. An appendix included sections on terminology, classifications of accounts and illustrations of recommended reporting.

The 1951 publication had listed fourteen principles and eight procedures. The 1968 publication lists thirteen "Basic Principles." Principles are defined as

> specific fundamental tenets which, on the basis of reason, demonstrated performance, and general acceptance by public administrations, accountants, and others concerned with public financial operation, are generally recognized as being essential to correct analysis of financial operations and to the proper preparation and presentation of required financial statements and reports.[9]

The study also states that

> The term 'principle' is used here with substantially the same meaning and in the same sense that it had been used by the national committee reponsible for accounting standards in colleges and universities.[10]

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[9] National Committee on Governmental Accounting, Governmental Accounting, p. 3.

[10] Ibid., p. 3.

The consultant on principles, Professor Graydon, is also Budget Officer of the University of Texas System, so this orientation is not surprising. The reference provided does little to shed much light on the meaning of "principle" as they intend it to be construed.

> Colleges and universities are nonprofit organizations. It is essential, therefore, that they set up their budgets, maintain their accounts, and present their financial reports in accordance with generally accepted accounting principles appropriate to nonprofit enterprises.[11]

The principles set forth in the 1968 study are discussed in the following pages and are summarized in Appendix IIE.

The first two principles of the 1968 study stress the necessity of compliance with organizational legal requirements. These principles are unchanged from the 1948 publication and provide a frame of orientation for the remainder of the set. The third principle recommends every governmental unit adopt a budget for control purposes over general government expenditures and revenues. The emphasis is placed on control rather than planning and no recommendation is made for a particular type of budget such as performance or program type budgets. The 1968 publication stresses the integration of the budget and financial accounting system through an elaborate system of journal entries.

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[11] National Committee on the Preparation of a Manual on College and University Business Administration, College and University Business Administration, (Washington: National Council on Education, 1952), p. 16.

Four principles in the 1968 publication relate to implementation of fund accounting. The changes from previous publications are minor, such as changing the names of several fund accounts. The principle relating to recording of depreciation on fixed assets was also relatively unchanged. Within the same organization, depreciation is recommended for some funds and not for others. The same type of ambiguous stand was taken in regard to the basis of accounting. A more detailed analysis of these two problem areas is taken up in Chapter V.

The recommended format of financial statements does not differ substantially from those of previous Committee recommendations. In Appendix IG the four basic statements recommended for the General Fund are illustrated.

In addition to the "Basic Principles" which are specifically enumerated in the publication, the 1968 publication also refers to a less well defined set of concepts, conventions, practices, and procedures applicable to private business enterprise which are utilized in governmental accounting. It lists in this set double entry bookkeeping, consistency, objectivity, cost, full disclosure, materiality, and conservatism.

Only one concept, "consistency," is defined.

> Consistency principle holds that the accounting for an economic enterprise must be consistent or identical in substance as to provide maximum

comparability of results for two or more fiscal periods.[12]

This writer has not been able to find any relevant analysis or criticism of this work. The very nature of the advisory commission, peer approval type structure, appears to stifle any criticism.

The methodology used in determining "basic principles" is not spelled out in the study. Of interest also would have been the comments and suggestions of the advisory committee's reviewers, which were not published. It would have been enlightening to know what concepts had been considered but rejected as "basic principles," and what selection criteria were used. An empirical study of actual practices would also have been informative. Whether true or not, to a considerable extent, the present study appears as just a rehash and rewording of previous National Committee publications.

A Statement of Basic Accounting Theory
Accounting for Not-for-Profit Organizations

From the mid 1930s through the 1950s, the American Accounting Association issued a series of publications relating to accounting principles. The general approach of the effort was to establish "broad basic principles" upon which to base corporate financial statements which would make the statements

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[12]National Committee on Governmental Accounting, Governmental Accounting, p. 3.

sufficiently uniform and understandable to justify opinions regarding the financial condition of the firm.

In 1964 the association embarked on a new research program: "Believing the 'series' inaugurated with the 1936 statement had served its purpose and that the time had come for the Association to undertake a new and different kind of effort."[13]

The Executive Committee of the Association picked a committee of nine, eight educators and one practitioner. In 1966 they completed and published A Statement of Basic Accounting Theory.

The charge given to the Committee had been to

> . . . develop an integrated statement of basic accounting theory which will serve as a guide to educators, practitioners, and others interested in accounting. The statement should include adequate support for any position taken and sufficient explanation to provide clarity, yet be as concise as feasible.[14]

The ideas and concepts incorporated by the Committee in their statement are on the whole readily traceable to accounting literature. What the Committee proposed, however, differs widely from common practice: "[The] document is a revolutionary one when its contents are compared to contemporary practice and education."[15]

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[13] American Accounting Association, Basic Theory, p. v.

[14] Ibid.

[15] Robert Sterling, "A Statement of Basic Accounting Theory: A Review Article," Journal of Accounting Research, V (Spring, 1967), p. 95.

The Committee adopted a deductive methodological approach as opposed to the previously utilized inductive or empirical methods. Essentially they regarded the function of theory as prescriptive rather than descriptive. This approach as one author states was

> diametrically opposed to the Paton-Littleton method of weaving together current practices into a coherent whole, and to Grady's method of inventing current practices and then justifying them.[16]

This committee defined accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information."[17] This was a broader definition than the traditional offerings. Accounting information was not to be limited to transaction data but was to encompass various types of non-transaction data as well. The committee also did not limit their concepts to profit-oriented organizations, "but also to the activities of individuals, fiduciaries, governmental units, charitable enterprises, and similar entities."[18]

The Committee in formulating their "theory" went through a number of steps. After defining accounting, the "Objectives of Accounting" were determined.

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[16] Ibid., p. 96.

[17] American Accounting Association, Basic Theory, p. 1.

[18] Ibid.

> The objectives of accounting are to provide information for the following purposes:
>
> 1. Making decisions concerning the use of limited resources, including the identification of crucial decision areas, and determination of objectives and goals.
> 2. Effectively directing and controlling an organization's human and material resources.
> 3. Maintaining and reporting on the custodianship of resources.
> 4. Facilitating social controls and functions.[19]

The Committee then determined standards for accounting information as well as guidelines for communicating accounting information. The criteria for standards were based on the all inclusive criterion of usefulness which the committee believed too general a concept for theory formulation. The standards recommended by the committee were:

> Relevance is the primary standard and requires that information must bear upon or be useful associated with actions it is designed to facilitate or results desired to be produced. Known or assumed informational needs of potential users are of paramount importance in applying this standard.
>
> Verifiability requires that essentially similar measures or conclusions would be reached if two or more qualified persons examined the same data. It is important because accounting information is commonly used by persons who have limited access to the data. The less the proximity to the data, the greater the desirable degree of verifiability becomes. Verifiability is also important because users of accounting information sometimes have opposing interests.
>
> Freedom from bias means that facts have been impartially determined and reported. It also means that techniques used in developing data

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[19] Ibid.

> should be free of built-in bias. Biased information may be quite useful and tolerable internally but it is rarely acceptable for external reporting.
>
> Quantifiability relates to the assignment of numbers to the information being reported. Money is the most common but not the only quantitative measure used by accountants. When accountants present non-quantitative information in compliance with the other standards they should not imply its measurability. Conversely, when quantitative information is reported without a caveat the accountant must assume responsibility for its measurability.[20]

These standards were to serve as "yardsticks" against which current practices could be measured so that recommendations for improvement could be made. The Committee also set forth guidelines for communication which they said were important but less fundamental than standards:

1. Appropriateness to expected use.
2. Disclosure of significant relationships.
3. Inclusion of environmental information.
4. A uniformity of practice within and among entities.
5. Consistency of practice through time.[21]

The Committee then illustrated how the standards should be applied for financial reporting. Of particular interest is the chapter on external users. The Committee noted that although external users of financial statements are a "heterogeneous group" with many varying interests it is possible to

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[20] Ibid.

[21] Ibid.

to develop significant accounting information even though the precise and total needs of the users are not known. Among the primary uses of financial statements by external users they identified

(a) predicting earnings of a firm for a future period,
(b) predicting future financial position and debt-paying power,
(c) predicting management effectiveness in future periods,
(d) accounting for economic resources entrusted by one person or entity to another.

One of the most significant recommendations of the Committee to improve financial reporting for external users was to suggest that current-cost information as well as historical-cost information be included through use of multi-column statements.

Criticisms of this publication generally fell into two categories, the practical problems of implementation and documentation, and the methodology of the study. Among the "practical problems" mentioned have been: cost of obtaining the additional data, interplay between standards, hesitancy of management to reveal confidential information, and the subjective nature of the standards.

> Accepting for discussion the soundness of the proposed structure, one may nevertheless readily foresee serious difficulties in putting it into use.[22]

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[22]Ernest L. Hicks, "Comments on A Statement of Basic Accounting Theory," Journal of Accountancy, CXXIII (September, 1966), p. 38.

Criticisms on the theoretical level generally related to the absence of explicitness and persuasive argument. For example, Sterling noted in his review that the Committee had included a "definition of accounting and deductive reasoning, both of which are radical changes . . . without justification for either."[23]

It is difficult to judge how the statement will fare in upgrading accounting education. The research group of the Canadian Chartered Accountant noted several years after its publication

> . . . little evidence that the statement has achieved much recognition or study by other professional accounting organizations or by members of the profession and business world.[24]

The connecting link between theory and practice is the education of practicing accountants. The writer personally believes the American Accounting Association's efforts, which did not stop with this publication, will over time have significant impact on practice.

The American Accounting Association's Executive Committee after completion of a Statement of Basic Accounting Theory established, in 1966, a Committee on Accounting Practice of Not-for-Profit Organizations. This Committee was charged as follows:

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[23]Sterling, "Review," p. 98.

[24]Gertrude Mulcahy, "A Statement of Basic Accounting Theory," Canadian Chartered Accountant, XCIII (October, 1968), p. 267.

> To review accounting practices of not-for-profit organizations, to assess their merits in the light of the standards for accounting information suggested in the 1966 AAA Statement of Basic Accounting Theory, and to suggest changes which might serve as a guide for further improvement in the form and content of reports, both for internal and external information, in the 1970's.[25]

A review was made by committee members of authoritative statements of principles or standards of accounting and reporting for not-for-profit organizations and a "considerable" number of NFP organizations reports. (This review included Governmental Accounting, Auditing, and Financial Reporting.) The recommendations of the various associations were subjected to a comparative analysis and specific topics for study decided on. Each topic was assigned to two separate subcommittees of two men. The Committee published their official report in 1971.

The conclusion of the committee upon completion of their study was that:

> . . . current accounting and reporting practices of most NFP organizations being almost exclusively evolved from and focused upon legalistic dollar accountability for individual fund entities on a year-by-year basis, often lack relevance and freedom from bias and do not adequately fulfill the objectives of accounting as proposed in a Statement of Basic Accounting Theory.[26]

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[25] American Accounting Association Committee on Accounting Procedures of Not-for-Profit Organizations," "Not-For-Profit," p. 83.

[26] Ibid., p. 86.

The committee also concluded that while the differences between NFP and profit oriented firms have been emphasized, the similarities that exist have been largely minimized. They held that NFP organizations needed an information system to provide data for both planning, directing, and controlling as well as evaluation of the utilization of scarce resources. They found the data provided by current financial reporting practices of most NFP organizations produced data biased, inappropriate, or inadequate for decision making and evaluation purposes. They recommended that additional supplementary data be accumulated and reported to meet these needs. Their findings and recommendations in specific areas are summarized below:

Fund Accounting

Current accounting and reporting practices are overly focused on fund accounting. Supplementary statements combining and consolidating this information relative to the entity or a whole must be developed.

Budgetary Accounting

Budgetary accounting practices have almost exclusively been limited to granting dollar spending on obligational authority with attention rarely given to operational accountability for the resources of the entity as a whole over longer periods of time. They recommended use of cost-based budgetary data, implementation of

cost-based standards of performance and standard costing techniques, and analyses of controllable costs and cost responsibilities.

The Basis of Accounting

Practice reflects the effects of legalistic fund and budgetary requirements and varies widely among entities. Full accrual basis was recommended as a generally accepted accounting principle for NFP organizations.

Fixed Assets

The committee found long-lived assets frequently not capitalized, those that were capitalized were often segregated in separate account groups; and that assets received through gift, donation, or bequest were frequently not accounted for. With the exception of hospitals and some organizations of the Federal Government, depreciation was generally not accounted for. There were inconsistent and inadequate handling of long-life assets at their disposal. They recommended fixed assets from all sources should be recorded. Expenditures for long life assets should be capitalized rather than expensed. Acceptable depreciation techniques should disclose cost of use or consumption for all assets. Disposal and retirement of long life assets should be suitably accounted for.

Liabilities

The committee found loan proceeds often reflected as revenue, and debt retirements as expenditures. Liabilities were known but not recorded and contingencies were not reported on financial statements. They recommended all known entity liabilities be recognized and appropriately recorded, classified and reported. Neither receipts from, or retirement of debt should appear on an operating statement.

Cost Accounting

Potentials of accrual-based cost accounting techniques have scarcely begun to be realized because of attention to legalistic and budgetary accounting. Cost accounting may be even more important in NFP organizations than in the private sector. They recommended integration of contemporary cost accounting techniques into the information system particularly those measuring efficiency.

Reporting

Published financial reports, they found, were prepared on a fund-by-fund and year-by-year budgetary basis with no consolidated or combined statements being prepared. They recommended preparation of consolidated fund statements and statements of operations and financial condition to supplement the usual separate fund statements; that improved

attempts be made at full disclosure through increased use of footnotes, parenthetical disclosure, and descriptive information.

The report of the Committee on Accounting Practices of Not-for-Profit Organizations has been published so recently that criticism, if any, is yet forthcoming.

The Committee anlyses and findings deal with all not-for-profit organizations including local governments. The Committee's "sphere of concern" was limited in its charge to the relationship of current practices to the four basic standards suggested in the 1966 Statement of Basic Accounting Theory. The Committee did not attempt to set forth a comprehensive list of accounting principles for not-for-profit organizations. Although the Committee states it performed a fairly comprehensive empirical study of current accounting practices, the methodology or specific tabulated results of this study are not shown.

The Committee did provide an appendix with illustrative worksheets and approaches for preparation of consolidated and consolidating financial statements. These illustrations and the detail provided in discussions of various problem areas combine to make this one of the most informative reports on accounting in nonprofit areas yet published.

Accounting Research Study Number 7

The American Institute of Certified Public Accountants is generally considered the most influential organization in

the United States concerned with the development of generally accepted accounting principles. Prior to 1960 the AICPA had devoted its attention almost entirely to resolving specific accounting problems rather than development of general accounting principles. In 1959 the Institute responding to both internal and external pressures embarked on a new program to "advance the written expression of what constitutes generally accepted accounting principles."[27] An Accounting Principles Board and a permanent accounting research staff were organized to carry out the research program. The research program called for studies to be made by independent investigators working under the advisement of the Director of Accounting Research and a project advisory committee. The results of investigation and findings were to be published to stimulate discussion before the Accounting Principles Board made a pronouncement. The official pronouncements of the Board, "opinions," are issued periodically contingent upon a favorable vote of at least two-thirds of the Board members. This new approach was intended to be broader in scope than previous efforts and to rely more heavily on the "deductive" method in development of accounting theory. Opinions were to be based on broad principles and research, rather than representing opinions of individual Board members.

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[27]Report to Council of the Special Committee on Research Program," Journal of Accountancy, CVI, (December, 1958), p. 62.

The research committee proceeded initially in an orderly fashion. The proposed plan called for the first step to be the formulation of a set of postulates to provide direction for a study on broad principles. Other research projects in specific areas were assigned to academic personnel. The Accounting Principles Board's reaction to the research on postulates and principles was to provide guidelines to these researchers.

The AICPA's special Committee on Research Program stated,

> postulates are few in number and are the basic assumptions on which principles rest. They necessarily are derived from the economic and political environment and from the modes of thought and customs of all segments of the business community.[28]

The concept of postulates was not an innovation for the term had been utilized decades before by such accounting pioneers as May and Paton.

The initial studies on the formulation of the basic postulates and principles of accounting were published in the early 1960s. In Accounting Research Study No. 1, The Basic Postulates of Accounting, the author, Berkeley Professor Maurice Moonitz, identified fourteen "basic" postulates upon which accounting principles are to rest.[29] The companion research study was authored by Professor Moonitz and fellow Professor

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[28] Ibid., p. 63.

[29] See Appendix II-F for a summary of the "postulates" as published in this study.

Robert Sprouse and was entitled Accounting Research Study No. 3, A Tentative Set of Broad Accounting Principles for Business Enterprises.[30] The accounting principles set forth by the authors were essentially prescriptive and contained considerable deviation from accepted current practices. For example, under these recommended principles the profit resulting from operations would be recognized in stages, financial statements would show the effect of price level changes, and plant and equipment would be restated periodically in terms of current replacement costs.

These studies drew largely unfavorable responses from accounting practitioners. Upon publication of the study on accounting principles the Accounting Principles Board stated,

> While these studies are a valuable contribution to accounting thinking they are too radically different from present generally accepted accounting principles for acceptance at this time.[31]

Myron Gordon summed up the feelings of many academicians when he noted,

> Consideration of the nature of postulates and principles and their relation to each other reveals that the Moonitz and Sprouse approach

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[30] See Appendix II-G for a summary of the principles as published in this study.

[31] Statement by the Accounting Principles Board (New York: American Institute of Certified Public Accountants, 1962).

> is at best difficult to implement and unlikely to succeed.[32]

The rejection by practitioners of the studies dealt a severe blow, at least on the surface, to the AICPA's plan for clarifying generally accepted accounting principles. The research reports, while not intended to be automatically applied by the Accounting Principles Board, it had been hoped would serve as a basis for its subsequent authoritative pronouncements.

One of the chief criticisms of the studies was that they combined prescriptive principles, to which the studies' authors believe accounting should conform, with descriptive principles of what was practiced. In June, 1963, the Accounting Principles Board approved a project intended to provide a descriptive set of generally accepted accounting principles. Paul Grady was commissioned to "identify and codify the accounting principles for business enterprises which have achieved general acceptance."[33] Grady was a very well-respected practitioner. He had retired as a partner from the prestigious "big eight" firm, Price, Waterhouse and Company, and was to serve for several years as director of research for the American Institute of Certified Public Accounting. During his career, he served as chairman on

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[32]Myron J. Gordon, "Postulates, Principles and Research in Accounting," Accounting Review, XXXIX, (April, 1964), p. 253.

[33]Paul Grady, "Outline for Inventory of Generally Accepted Accounting Principles for Business Enterprises," Journal of Accountancy, CXVI, (November, 1963), p. 52.

numerous Institute committees, including auditing procedure, relations with the SEC and practice review. He also served as chairman on the Hoover Commission Task Force on Government Lending Agencies. In 1959, he had received the Institute's gold medal for distinguished service to the accounting profession.

Grady had advocated such a study for a number of years.

> There could be great merit in having a brief summary of generally accepted accounting principles . . . The problem is largely one of identification of the principles on which there is general agreement and of developing a useful pattern of arrangement or classification.[34]

In mid 1965 Accounting Research Study Number 7, Inventory of Generally Accepted Accounting Principles for Business Enterprises, was published. In this study, Grady relied very heavily on previous AICPA pronouncements, the Accounting Bulletins and on Montgomery's Auditing, a widely used auditing text.

In this study, Grady defined accounting

> Accounting is the body of knowledge and functions concerned with systematic originating, authenticating, recording, classifying, processing, summarizing, analyzing, interpreting, and supplying of dependable and significant information covering transactions and events which are, in part at least, of a financial character, required for the management and operation of an entity and for the reports that have to be submitted thereon to meet fiduciary and other responsibilities.[35]

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[34]Paul Grady, "The Quest for Accounting Principles," Journal of Accountancy, CXIII, (May, 1962), p. 45.

[35]Paul Grady, "Inventory of Principles," p. xi.

In this study, instead of utilizing the term "postulates," Grady returned to the term "basic concepts," which had been used in some earlier accounting publications.

> The term 'postulates' is not being used. It is believed that the term 'basic concepts,' which had been used in the pamphlet Corporate Accounting Standards, published by the American Accounting Association, is better understood.[36]

Grady stated that the basic concepts underlie or permeate accepted accounting principles, and that they could be derived from experience.

Of the ten concepts listed by Grady, half of them represent concepts which, judging by current accounting texts, are generally agreed upon: business entity, going concern, monetary expression in accounts, consistency between periods for the same entity, and materiality. The remaining "basic concepts" set forth by Grady lack the general acceptance of those previously mentioned. Other basic concepts such as the "cost concept," "realization concept," "accrual concept" usually listed in accounting literature are not listed as such but are to some extent implied.

Grady took what he defined as a "pragmatic" approach to summarizing accounting principles. His purpose was to list broad objectives, standards of accounting performance and measurement, and standards of disclosure which had reached an

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[36] Ibid., p. 25.

accepted status in the United States. Grady lists five objectives or "fiduciary accountabilities" which he states are oriented to fair presentation. The principles presented are grouped under five headings: (A) Income and Expense, (B) Equity, (C) Assets, (D) Liabilities, and (E) Financial Statements.

The principles Grady stated represent steps or means required in meeting the objectives. The "basic concepts" and the "principles" as formulated by Grady are summarized in Appendix II-H and II-I.

Grady provided references for each principle, the basis of "General Acceptance," in the form of previously published Accounting Research Bulletins, Security and Exchange Commission Regulations, or opinions of the Accounting Principles Board. The majority of his "Objectives" and "Principles" in this study had been outlined in detail in a magazine article published before the study had even been authorized.[37] With the exception of advocating price level adjustments, long a favorite theme of Grady, and Chapter 10 in which he gives his views on the narrowing of areas of difference controversy, Grady was careful to focus on the accepted.

Reaction to Accounting Research Study No. 7 has been mixed. An editorial of the Journal of Accountancy characterizes it as

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[37]Grady, "The Quest," pp. 47-49.

> putting current problems in perspective, reminding all concerned of the great progress already made, highlighting areas of controversy and providing an invaluable guide to further deliberations of the Accounting Principles Board.[38]

Weldon Powell, the first chairman of the Accounting Principles Board, stated the book is "likely to be one of the most useful publications ever issued by the Institute."[39] On the other hand, Barton's comment probably summed up the criticism of many academicians: "The Inventory was essentially the combination of all the previous Accounting Research Bulletins. From his study of these Bulletins, Mr. Grady was able to observe that diversity of accounting practice was a well-founded principle of accounting."[40]

It should be noted that in Grady's study as published, the accounting principles were not the subject of an extensive research program. As previously noted, Grady had detailed almost identical concepts several years before the program was started. Neither were the principles "developed" supported by evidence of general practice.

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[38] "Editorial," Journal of Accountancy, CXIX (March, 1965), pp. 28-29.

[39] Weldon Powell, "Inventory of Generally Accepted Accounting Principles," Journal of Accountancy, CXIX (March, 1965), p. 29.

[40] A. D. Barton, "Accounting Principles. Why Uniformity," The Chartered Accountant in Australia, XXXIX (January, 1969), p. 617.

> . . . in the present study no attempt is made to provide any kind of empirical evidence to support what are said to be generally accepted principles.[41]

Powell, in his comments on Grady's study, alludes to files of such data collected for the study, but also notes its absence in the publication.[42]

All in all, Grady's study is the best summary available of what practitioners believe to be the basic principles of financial accounting for acceptable practice in the private sector and corresponds closely to undergraduate accounting texts. As Anthony noted, "So far as I can judge, the principles are an accurate and complete statement of what is generally accepted at the present time."[43] Grady's prestigious position, the circumstances of the study's publication, and its generally noncontroversial nature have generally led to wide acceptance by practitioners.

Accounting for NonProfit Organizations

The study conducted by Henke was originally commissioned in 1961 as a part of the research program of the American Institute of Certified Public Accountants. "The sixth and final research project now under way relates to the accounting of

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[41] R. J. Chambers, "A Matter of Principle," Accounting Review, XLI (July, 1966), p. 446.

[42] Weldon Powell, "Inventory," p. 34.

[43] Robert Anthony, "Review - Inventory of Generally Accepted Principles for Business Enterprise," Accounting Review, XLI (January, 1966), p. 195.

nonprofit organizations. Emerson Henke of Baylor University is conducting work on this project."[44] The findings of this study, however, were not accepted for publication by the Institute and the study was published eventually by the Bureau of Business Research of Indiana University in 1963. Presumably the recommendations of Henke varied too significantly from "practice" for acceptance by the Institute.

Henke characterized the purpose of his study as analyzing and evaluating accounting and reporting practices followed in the nonprofit area in the light of the environment within which the financial data are used.

Henke defined the object of accounting as, "to assist in the conduct of financial affairs by gathering, analyzing, and interpreting financial information and presenting it to the appropriate persons or groups."[45]

In developing his analysis, Henke first "postulated" that,

> accounting and reporting practices--to be useful--must be logically consistent with the objective that an organization seeks to achieve and with its operational pattern resulting from these objectives.[46]

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[44]Weldon Powell, "Report on the Accounting Research Activities of the American Institute of Certified Public Accountants," Accounting Review, XXXXVI, (January, 1961), p. 30.

[45]Henke, Accounting, p. 3.

[46]Ibid., p. 10.

Is this an implication that underlying the "theory" of accounting for nonprofit organizations there are basic postulates similar to those promulgated by Moonitz in his Accounting Research Study Number 1. Henke does not make this point clear. He does refer indirectly in later sections of his study to Moonitz's postulates of financial statements (B-1) and disclosure (C-5), as well as indirectly to objectivity (C-2) and consistency (C-3). Henke's study, as we have noted, was originally commissioned as a part of the Institute's research effort, and he was of course aware of Moonitz's study. He makes no direct effort to discuss applicability of Moonitz's postulates or present a set of his own. What he presents as the basic postulates upon which his methodology is based appears to be a play on words to combine rather unique concepts of relevance and consistency.

Henke then directed his attention toward defining the primary objective of nonprofit organizations as a group. He defines this objective of nonprofit organizations as providing a socially acceptable service for members of the social group without regard for any kind of an equity or membership interest in the entity.

He presents this as a "given" and references an article in the New York Certified Public Accountant which primarily discusses depreciation in nonprofit organizations. Neither Henke nor the article referenced shed light on how the objective was arrived at. Were other objectives considered? What criteria were used to pick this particular objective? Is it even possible

to arrive at the objective for such a broad spectrum of organizations as he has included in his study? Insofar as the objective of local government, professional literature records no consensus of objective even for that particular sub-set.

> There is, first of all, no agreement among urban residents as to why local governments exist at all. Some want these governments to serve primarily in order to provide for life's amenities; others see them as something of an arm of the local Chamber of Commerce, with the task of doing what is necessary in order to attract more business and industry to the area; a third group wants to keep down the cost of government at all levels and wants local government to restrict its activities to that which has been traditionally regarded as necessary; a fourth group, often consisting of self-conscious minorities, sees local government as an arbiter among many forces and a device whereby each minority gets at least some slice of the pie.[47]

Having determined the objective of nonprofit organizations, Henke then proceeds to present a comparison of organizational operating characteristics of profit-oriented and nonprofit organizations. These operational characteristics include: sources of capital and revenue, organization and control, justification of continued existence, evaluation of efficiency, and possible bias in preparation of financial statements.

Henke concludes, the operation of an enterprise under profit motivation depends upon the existence of an effective

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[47]Charles Adrian, Public Attitudes and Metropolitan Decision Making (Pittsburgh: Wherrett Memorial Fund, 1961), p. 7.

demand for the commodity it sells or the service it provides. In our society, there are certain essential human needs society has deemed must be satisfied for all persons, regardless of their ability to pay. These are fulfilled through the mechanism of nonprofit entities. The management of such an organization has a responsibility to provide services in an efficient a manner as possible.

In profit-oriented organizations, permanent capital is provided by investors seeking financial reward or service. In a nonprofit organization, incentive for contributing funds comes from the donor's desire to provide what he believes is a socially desirable service.

The constituency of a nonprofit organization, though not having ownership control of the organization, occupies a position similar to that of the owners of a profit making organization. The constituency of nonprofit organizations voice their dissatisfaction through withholding support or by vote. The nonprofit organization acts in a fiduciary capacity, and financial reports should reflect this trust.

The financial reports of most nonprofit organizations, he states, reflect no real effort to evaluate historic organizational efficiency to enable constituents to make wise resource allocations. Financial data while unable to provide the complete answer can disclose important facts. Costs become an important criterion for judging efficiency in the absence of net income and accounting reports should be organized to disclose these data.

In preparing financial statements of nonprofit organizations, care must be taken to prevent bias. The financial position should not be understated to aid in fund solicitation. Fund-raising costs should not be hidden in other categories. Revenues should not be overstated to inflate success. Excess revenues over expenses should not be buried in appropriation accounts but clearly shown.

From this examination of these operational characteristics and their associated objectives, he "tentatively concludes" financial statements should be directed toward an effective disclosure of:

1. The extent to which their primary service objectives have been achieved.
2. The efficiency with which their operations were conducted.
3. The stewardship of their management.

Measurement and reporting of effectiveness, efficiency and legal accountability as ends for an information system have an acceptance by knowledgeables approaching consensus. The problem has always been, and remains, how to accomplish these ends. Henke states that these criteria require that financial statements show (a) the amount of resources available to an organization at particular times and (b) the changes in amounts of resources available to them over specific periods of time. How Henke arrived at these financial statement requirements from the criteria for disclosure is not explained.

Henke then determined the parties interested in the financial reports of nonprofit entities. This, he states, was done by conference, observation, correspondence, and analysis. Henke states three basic questions which need to be asked of the users. What decisions are made? What information is required to make the decisions intelligently? How should the information be organized for effective presentation? Henke did not present any empirical basis of his study of user needs. Most of the conclusions listed appear at best truisms.

(a) External management group - (board of trustees, directors, etc.)

Responsibility for making plans and policies evaluating efficiency of internal management, and seeing that the organization moves towards its objectives in an efficient manner.

(b) Constituency - (all who directly support the organization through the contribution of time or resources without receiving equivalent tangible benefits in exchange.)

This group is particularly concerned with answering questions of whether the organization is providing the service in an efficient manner and using its resources for the intended purpose.

(c) Customers

Services users have a right to judge whether implication of not realizing a profit in the long run is being met and whether its charges are excessive because of operational inefficiencies.

(d) Public

This group is primarily concerned with defining the social benefits within which special privileges will be granted to nonprofit organizations.

(e) Creditors

Primary concern of creditors of nonprofit organizations is with the ability to meet obligations of future interest and principle payments.

(f) Other groups - (includes employees, regulatory and accrediting agencies.)

The objectives to be achieved by financial statements Henke then determined by "logical deduction."

Henke lists the following conclusions regarding useful financial reports as "emerging from his discussions."

1. An objectively determined operating statement that will help the interested groups to judge operating efficiency is desirable for appropriate financial reporting among nonprofit organizations.
2. Because budgetary control and legal restrictions through the medium of appropriations are so important in the nonprofit area, it is desirable to present a statement showing the sources and applications of net current operating resources.
3. An appropriately prepared statement fairly presenting the financial condition constitutes an important part of the financial reports of any nonprofit enterprise.
4. All financial statements should be prepared in an objective and consistent manner to be most useful to all interested groups.
5. The financial statements should articulate with each other and should form a "connecting-link" history of the organization over its life.
6. Nonprofit financial reports should disclose, insofar as is practically possible, the extent to which the professed objectives of the organization have been achieved.
7. Nonprofit financial reports should include all practically available factual data that could logically be helpful to any of the external interested groups in evaluating the efficiency of operations and internal management. Because a service objective is substituted for profit motivation in this area, the interested groups, other than the customers and creditors, should have a primary interest in the extent and efficiency of services rendered rather than in the difference between revenues and expenses or expenditures. Financial statements should be organized with the recognition of this need.

8. A nonprofit organization is a fiduciary type of entity. Therefore, financial reports should clearly reflect the way in which the stewardship function has been performed. In an operating nonprofit entity, this will normally require disclosure of the way in which the operating responsibility has been met as well as the extent to which specific obligations relating to "dollar accountability" have been carried out.
9. Because the public has granted nonprofit organizations certain special privileges and because customers depend upon these entities to operate essentially on a break-even or planned-growth basis, these groups have a larger and more direct interest in the financial data for such entities than they have in the reports for profit enterprises.
10. The public and constituency may rely to some extent upon accrediting agencies to form some judgments for them. However, attention should be given to presenting certain important key facts in condensed form for these groups to use directly.[48]

Henke turned his attention to the "major" problem areas of accounting for nonprofit organizations and the existing statements of principles. The report does not deal, he states, with practices that are "noncontroversial." He includes in this discussion:

(1) Bases of accounting.

The accrual basis should be used in accounting for any nonprofit organization engaged in the management and conversion of economic resources.

(2) Depreciation.

Depreciation should be recorded by all nonprofit organizations in which objectively determined costs and the measurement of changes in the amount of resources available are considerations in

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[48] Henke, Accounting, p. 32.

evaluating the effectiveness of operations or are useful for decision purposes.

(3) Pledges Receivable.

Pledges receivable should be shown as assets under the accrual method of accounting.

(4) Appropriations.

Appropriations should not be recorded as expenditures in a revenue and expenditure statement as applications in a statement of source and application of net operating resources or as expenses in a statement of revenue and expenses.

(5) Encumbrances.

Encumbrances should be included in the statement of source and application of funds.

(6) Imputed Costs.

As a minimum it is desirable to impute an amount for services rendered by unpaid or grossly underpaid professionally trained personnel.

(7) Adequate disclosure.

The statements should disclose whatever is necessary to make them not misleading to interested groups. The financial statements should be organized to show the rights and responsibilities of management in the use of organizational resources and the extent to which the objectives of the organization have been met.

In making recommendations on both the basis of accounting and depreciation, he left the way open for deviation. Henke, although recommending the accrual basis, stated cash or modified accrual bases were acceptable when results produced would not be "significantly different" from those resulting from the accrual method. Depreciation under his ground rules would presumably not be required when not needed for decision making. The concepts advanced to improve financial statements are neither presented in enough detail or illustrated sufficiently to make innovative propositions clear.

Financial Statements

Henke recommended four basic financial statements for nonprofit organizations.

1. The Balance Sheet.

   Should disclose all assets held by the organization together with claims against them in one combined statement; resources should be subdivided between operating resources and restricted resources; liabilities should be grouped so that claims against particular resource groups can be matched.

2. Statement of Revenues and Expenses.

   Should be all inclusive reporting all revenue available to the entity available for general operating purposes; extraordinary sums of revenue to be accounted for in such a manner as to preserve the "normal operating picture"; revenues should be classified by sources and expenses by functional classification appropriate for organizational structure.

3. Statement of Changes in Equity Balances.

   The extent to which capital of the organization has been maintained augmented or diminished; a condensed form showing beginning balances by fund changes during the period and ending balances.

4. Statement of Sources and Applications of Appropriate Funds.

   Should show the extent of compliance with the accepted budget, including dollar accountability for current receipts and outlays and encumbrances.

No examples of these statements are provided.

Considered in totality, Henke's study is disappointing. He had the backing of the prestigious Institute and one must assume the time and the resources to do a well-planned, detailed study. The study, as published, left this writer very disappointed, not because of recommendations that deviate from current practices, but rather for what Henke could have done

and did not. This would include tracing the evolution of accepted techniques that are peculiar to nonprofit accounting, performing a comprehensive empirical study of current accounting practices in nonprofit organizations, providing workable examples of operating statements where financial and other quantitative data are combined to present a comprehensive picture.

Henke's study of accounting for nonprofit organizations does include the set of organizations with which this work is concerned, local government. When reading the entire report, however, this writer received the distinct impression that Henke's main thrust was aimed toward voluntary organizations in the health and welfare area.

Henke's study, it should be noted, did not concern itself with all nonprofit organizations. He specifically excluded the federal and state governments, mutual savings banks and insurance companies, cooperatives, labor unions and private dues-sustained clubs. He presents no reason for this limitation. One can either conclude his research showed that the findings and recommendations of his report were not applicable to these organizational types or more likely the range of his analysis did not extend to these organizations.

Although Henke outlines the methodological plan he utilized in his study the individual parts and their interconnectiveness to form the total methodology never clearly fit together, at least to this writer.

Summary

In this chapter recent major publications on the broad problem area were reviewed in considerable depth. For each work highlights of the background of the study, methodology used in this study, and major recommendations and findings were presented and contrasted.

The 1968 publication of the National Committee on Governmental Accounting (Governmental Accounting, Auditing, and Financial Reporting) is the latest and most comprehensive of an accounting publication series dating back to the 1930s. The moving force behind the continuing effort has been the Municipal Finance Officers Association, although an attempt to create a broad base of advisory support has been included in the total program.

This publication is slanted heavily toward the need of municipalities, unlike the other works reviewed, which aimed at the broader set of all nonprofit organizations. The publication includes: (1) a set of basic "principles" of governmental accounting, (2) discussion of and sample entries for problem areas in each major fund, (3) model financial reports including statements for individual funds, combined statements for the organization as a whole, and statistical tables, (4) a discussion of and checklist for auditing of governmental units, (5) a sample chart of accounts suitable for most municipalities.

The publication mentions some basic concepts frequently referred to in accounting literature such as consistency and objectivity, but is vague on their relationship to the

principles presented and presents no comprehensive listing. The publication lists thirteen basic principles or "fundamental tenets." The publication presents no reasoned account of how the principles were determined. Continuing the historic trend found in these publications, basic recommendations varied but slightly from those previously published and reflect the slow evolution of the concepts of "good municipal practice." For the most part, the "principles" as published are concerned with the peculiarities of the accounting system that has evolved for municipalities. For example, six out of thirteen principles relate either to environmental legal constraints or fund structure. Considering the principles and recommendations as a whole, if a city or county adhered to the promulgations in their financial reporting the resulting financial presentation would provide an adequate legal accountability of the cash flow through the organization, for a budget period.

The authoritative nature of the National Committee on Governmental Accounting's pronouncements, it would seem, have until recently past been an inhibiting factor on the amount of published independent research performed in the area of governmental accounting. Compared to many other subfields of accounting the literature is relatively devoid of publications.

Judging by the quality of audit reports and financial statements prepared by CPA's, the American Institute of Certified Public Accountants has not adequately addressed itself to

the local government accounting problem area. Presumably if the planned deductive approach, that the Institute initiated at the start of the 60s, had proven successful, the postulates formulated would have served as a basis not only for principles of accounting for the private sector, but for the public sector as well. This must have been what the committee on Research Program had planned when Henke was commissioned to do a research program on accounting for non-profit organizations.

The Institute's planned approach using the "deductive method" at least as implemented proved unacceptable to the majority of practitioners. As recounted the principles of accounting for business enterprises (Accounting Research Study Number 3) "based" on the postulates were rejected as being too "radically different" by the sponsoring organization. In looking at the "postulates" of accounting as published in Accounting Research Study No. 1, this writer finds it difficult to see how they would furnish "direction" in determining a set of accounting principles for local governments. Specifically, the postulates did not serve as suitable criteria for selection between alternative principles of local government accounting.

When the thrust of the Institute's initial approach as implemented in Accounting Research Studies No. 1 and No. 3, was blunted, Paul Grady, a long time practitioner, was commissioned to inventory accounting principles as actually practiced by business enterprises. Although Grady evidently had the principles determined before the "research" for the study was

started, the work is generally accepted by practitioners as a "good" inventory of accounting principles as practiced by private enterprises.

Grady, in presenting his analysis, set forth a list of basic concepts, which he stated "underlie" accounting principles, and a separate list of generally accepted accounting principles.

The basic concepts as "derived" by Grady from experience, and as we shall see, the local government "accounting system rules" determined in this study by examination of actual financial reports, are similar in many respects. The similarity is to be expected, because of the reliance in both public and private sectors on the basic double entry bookkeeping system for much of the basic record keeping process.

Grady's inventory of principles are grouped under five objectives (Income and Expenses, Equity, Assets, Liabilities, and Financial Statements). These principles reflect "good" practices in the private sector. As such, they are worded to effect periodic income determination and reflect the attendant matching of realized revenues and associated incurred costs.

As previously noted, Henke's study was published by Indiana University after apparent rejection by the sponsoring AICPA. The stated purposes of this study, Accounting for Nonprofit Organizations, were to evaluate the accounting and reporting practices of nonprofit organizations in light of the environment in which they existed. Henke's theoretical framework started by postulating that accounting practices must be

consistent with the objective of an organization and its operating pattern in order to be useful. After examination of the peculiar operational characteristics and associated objectives of nonprofit organizations, he concluded the financial statements for nonprofit organizations should provide disclosure of organizational effectiveness, efficiency, and managerial stewardship. He recommended that a set of four statements (balance sheet, statement of revenues and expenses, changes in equity balances, and sources and application of funds) be so constructed that they provide a comprehensive historical organizational picture.

The American Accounting Association in 1964 undertook a new approach to formulation of basic accounting theory. In 1966 the Association published a study which attempted neither to justify, nor to construct, a coherent theory for current accounting practices. The authors rather presented a set of prescriptive standards for accounting information, and guidelines for communicating such information. The standards (relevance, verifiability, freedom from bias, and quantifiability) were intended as "yardsticks" to measure current practices so improvements could be made. The concepts as developed in this study were intended to be applicable to both profit and nonprofit organizations. A committee was appointed by the Association to review accounting practices of not-for-profit organizations using the newly developed standards and to suggest prescriptive changes. The report of this committee was published in 1971 in the Accounting Review. The Committe's

findings were very critical of current accounting practices of not-for-profit organizations. The report made a number of prescriptive recommendations on key problem areas.

The studies by Grady and the National Committee on Governmental Accounting are similar in many ways. The studies both were establishment efforts, sponsored and financed by the official body in their respective areas; were to be to a considerable extent descriptive lists of principles relating to good practice as viewed by the more conservative practitioners in each field; were not grounded on extensive empirical analysis or deductive reasoning but relied almost exclusively on reordering and review of previous organizational pronouncements; did not contain major recommendations for significant departure from accepted "good" practices; were attempts at providing complete listings of principles; and did receive relative rather widespread practitioners' acceptance.

The studies by the American Accounting Association Committees and by Henke in contrast were based primarily upon a deductive approach; essentially represented academic efforts to improve major shortcomings in existing practice and in that sense recommendations were prescriptive; primarily concentrated on analysis of key problem areas rather than providing comprehensive listings of principles; have not received wide acceptance from practitioners.

Grady's study was directed toward business enterprises. The publications of Henke and the American Accounting Association are directed toward the broad set of all nonprofit organizations.

The efforts of the National Committee on Governmental Accounting have been directed specifically at local government units.

Although Grady's work was directed toward business enterprises, certain applications are not restricted to that set. Most of the basic concepts advanced by Grady, including consistency, materiality, going concern, conservatism, and monetary expression, have wide applicability to operational characteristics in nonprofit organizations.

The studies by Henke and the National Committee refer to such basic concepts or postulates but do not provide encompassing lists of what they are. It should be noted that few accountants working in the nonprofit field have specific accounting training for that field. They are most familiar with the "basic concepts" as listed in elementary texts which most closely correspond to those as advanced by Grady.

In some other areas, the studies by Grady and the National Committee on Governmental Accounting do not conflict. The first two principles of the National Committee study dealing with legal compliance; the third principle dealing with budgets; the eleventh and twelfth principles dealing with classification and terminology would probably fall into Grady's classification scheme as basic concepts rather than principles. They were specifically included in the list of principles by the National Committee on Governmental Accounting presumably because of historical problems encountered in the environment of local government organizations. In accounting for local

governments, for example, integration of a satisfactory budgetary system with the accounting systems has long been viewed as a cornerstone of good practice. This concept has been included as a governmental accounting principle since the first list of principles promulgated by the National Committee in 1934. There are, however, organizations which still lack budgets, so that perhaps the principle is necessary. Grady, on the other hand, considered the budget system necessary but not a part of the financial accounting-reporting system.

> Accordingly most of the dynamics and creative factors inherent in the design and operation of a modern accounting and budgetary system required to supply the needs of management are not dealt with. The existence of such a system is assumed as a condition precedent to fulfillment of external reporting requirements.[49]

Viewed as an integral whole, the "principles" as promulgated by Grady do not provide any direction or guidance for local government accounting and financial reporting. The basic orientation of Grady's principles toward measurement of corporate income does not provide a suitable conceptual framework for the principles of local government accounting.

In reviewing research published in accounting theory and accounting principles, the influence of an author's education, experience and position becomesapparent both in the nature of his findings and their acceptance by contemporaries. For

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[49]Paul Grady, "Inventory of Principles," p. 5.

example, Paul Grady was a long-time member and partner of a major public accounting firm. One would hardly expect his findings (Accounting Research Study No. 7) not to reflect what he and his peers practiced as "good" accounting. Any other finding would have been a contradiction of his professional life. On the other hand, in the case of Accounting Research Study No. 1 and No. 3, the authors (Moonitz and Sprouse) were academicians. After numerous disclaimers by academicians over the years that accounting practices could definitely be improved, one would hardly expect these authors to publish a study that would not at least in their minds, provide a platform for system improvement. The same finding holds true for studies by the National Committee on Governmental Accounting. Official pronouncements of the organization may be expected to refine, elaborate, or provide problem area solutions. It would be extremely unlikely, however, if the principles set forth would run counter to good peer group practice.

CHAPTER IV

FINANCIAL REPORTING PRACTICES IN LOCAL GOVERNMENTS

The objective of this chapter is to present for the reader a composite picture of actual financial reporting practices of local governments. The basic approach to the investigation performed in this chapter was to prepare an analysis of local government financial reporting practices in the State of Georgia and to compare the results of the analysis of this sample with the findings of other research performed in various localities. Do reporting practices vary between types of local governments? Do the financial reporting principles as revealed by practice correspond closely to those recommended by the National Committee on Governmental Accounting? This chapter will answer these and similar questions relating to the correspondence of practice to theory.

Financial Reporting in Georgia

This section of the chapter provides an analysis of financial reporting followed by local governments in Georgia. The analysis is presented in several parts. First to provide the reader with a more comprehensive picture of the existing local government system and actual financial reporting

practices the analysis is keyed to the reference frame of a specific urban county area in Georgia. Second, contrasting practices between similar units in Georgia will be reviewed.

In most instances, the term local government is associated with municipal or city government. Local government accounting prescriptions and research have invariably been keyed to our municipal units. In today's local government system, cities are, however, but one of the differentiated segments of a complex system that has developed. A researcher cannot validly take financial reports issued by cities alone and say that this is local government financial reporting. As local government developed in the United States, it evolved into specialized, separate, though interrelated, units, each with its own financial system. This subsection will endeavor to acquaint the reader with dimensions of this development and its effects on local government financial reporting.

The methodology used in the analysis in this section can be summarized as follows:

Step one--Choose a specific urban county. Richmond County in Georgia was utilized as the model. This county was chosen (a) because of its size; it is large enough to support a variety of local government services but not so large that size itself was a research barrier; and (b) because of the availability of data and the willingness of local public officials to cooperate.

Step two--Identify major functional units in the county area that provided a local government public service, received local government resources, and were subject to some measure of local control. Sixty-five such operating units were identified in the county area. For analysis purposes, these were divided into eight major functional areas. (As for example, public safety, health, and intellectual development). This enabled the writer to develop a systematic approach to the analysis.[1]

Step three--Develop a model of the information desired about each agency. This included: function, organization, revenue and expenditure pattern, intergovernmental relations, and financial administration.

Step four--Review data available in the form of financial statements, annual reports, studies by and of the various units, grand jury reports, board minutes, and statutes.

Step five--Interview local agency heads and where pertinent state and federal officials involved in intergovernmental financial administration.

Step six--Review, assess, and summarize the data into a comprehensive pattern and draw conclusions.

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[1]A list of the organizations and the functional grouping utilized in the study is shown in Appendix III-A. The form utilized in data collection is shown in Appendix III-B.

The analysis is presented in three parts: (1) a brief overview of the county area, (2) a review of the major functional units that have separate reporting systems, (3) general observations and conclusions.

Richmond county area

Richmond County is located in east-central Georgia, adjacent to the South Carolina border. The county's population has been increasing steadily since 1900, the most rapid growth occurring since 1940. The county's population grew from 81,863 in 1940 to 163,201 in 1970.

The only city of consequence in the county and the major commercial center is Augusta. While the total county population has grown, Augusta's population has, as have many core cities, declined and become increasingly black. (Augusta's population declined from a high of 71,508 in 1950 to 59,864 in 1970.) The city was the scene of a costly race riot several years ago.

Although the county was once heavily agriculturally oriented, during the last decades the county's economy has diversified considerably. Major employers of county residents include textile mills, the Atomic Energy Commission's Savannah River Plant and the Fort Gordon Military Reservation.

Within the last two decades, the size and scope of local governments within the county have grown significantly. Local governments' expenditures rose from $14 million in 1947 to $39 million in 1967.[2]

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[2]In Appendix III-C and Appendix III-D additional details

As counties go, Richmond (163,201) has a relatively large population (average county population in the United States is slightly over 50,000). However, sixty percent of the people in the United States live in counties with a population of over 100,000.

The structure, functions, and financing of local governments differ throughout the United States. These factors vary not only by state but by county size, location (urban--rural), and available resources. The average county area exists in statistical tables only.

On the whole experience shows that as a county area increases in population size, the local government structure becomes more complex. This is especially true of the very large metropolitan areas. On the other hand as a county decreases in population size so does the complexity of local government structure, but only to a point. A small county area in Georgia (population-wise) still has at a minimum separate city and county governments, a separate school district, a welfare unit, and a public health district.

The model used in this work, Richmond County, is meant to serve as a fairly representative example. The intent is to give the reader a better understanding of the complex nature of local government structure and the varying financial reporting

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on the tremendous increase in local government revenues and expenditures in the county area are shown.

practices. The intent was not to hold out the model either as an example of good or bad practices or to say that this is the average county area.

To aid the reader in his examination, a summary analysis is provided of the major resource users in the county area. This analysis includes information on various facets of the organization itself as well as its financial reporting. The major units so identified include:

a. City of Augusta,
b. Richmond County,
c. the public hospital,
d. the public health district,
e. the public school system,
f. the public library,
g. the public housing authority,
h. the public welfare organization.

(a) Augusta City Government

The city government provides a very wide range of services that benefit city and county residents alike. These include such varied functions as the local airport, a civic auditorium, public utilities, a golf course, police and fire protection, and cemeteries. The expenditures of the city run over $10 million a year. The city is governed by a mayor and sixteen council members and functions primarily through a committee system which considerably intertwines executive and legislative

functions. Augusta does not have a city manager. Many of the major departments such as the airport or utilities are virtually autonomous and are operated by "professional" administrators.

The chief financial officer of the city is the comptroller; however, he does not have authority for revenue collection. He maintains the primary financial system of the city but various major departments maintain separate financial records systems in considerable detail. Audit of city records has been performed by an "accountant" on the city's payroll, who is also father of the comptroller. This auditing practice has been a point of controversy for a number of years in the area, but it continues. The city issues an annual report which includes, among other items, a financial report.

The annual report is entitled the Year Book of the City Council of Augusta, Georgia. As well as the financial reports, it includes city ordinances passed during the year, departmental reports in varying detail, statistical data on the business community, and various miscellaneous data such as the mean temperatures by month and poems by local writers.

The financial report runs some sixty pages and contains dozens of separate schedules. The general impression of the writer is that the report contains much data but little information. The reports bear little resemblance to those recommended by the NCGA as to format, terminology, or scheme of classification. The report includes no comparative figures either by prior

year or budgeted, and no meaningful summarization technique by fund or in total is used. The statements are prepared on a modified accrual basis but this is not stated in the financial report. No letter of transmittal or explanatory notes of any type are included with the report. No depreciation is recorded on plant and equipment in any fund.

An examination of the balance sheet will help illustrate the rather unique approach to financial reporting utilized. The statement is entitled:

City Council of Augusta, Georgia
Balance Sheet
(Date)

[Over one hundred account balances are recorded under the three major headings of assets, liabilities and surplus. The assets of over one hundred accounts are recorded under fourteen separate subheadings.]

Cash,

Water and Sewerage System Revenue Fund,

Airport Revenue Fund,

Funds on Deposit,

Receivables,

Bond Fund,

Sinking Fund,

Other Special Funds,

Other Funds,

Trust Funds,

Incomplete Projects,

Capital Assets,

Semi Fixed Assets,

Other Assets.

[The liabilities of a dozen accounts are recorded under the following headings]:

Accounts Payable,

Other Liabilities,

Contingent Liability,

Bond Debt Current,

Bonded Debt.

Only one account entitled simply, surplus, which is used as a balancing account, amounting to $40 million, is utilized.

The remaining financial schedules provide a variety of data in various detail. (For example, five pages are devoted to listing the name, address, and yearly total of everyone receiving a city pension.)

A considerable number of the city's yearbooks are printed and are available on a first-come basis, but general distribution to the public is not made.

(b) Richmond County Government

As the county has grown, particularly in unincorporated areas, the county government has expanded tremendously in recent years. County government provides the judicial function,

local financial support for health and welfare activities, and in unincorporated areas construction and maintenance of roads, recreation, public utilities, and various other public services. County government expenditures amount to over $7 million per year. In theory the governing body of the county government is an elected five man board of commissioners who function through a committee system. There are though, in addition, numerous elected county officials (sheriff, superior court judges, clerk of the court, treasurer, ordinary, and tax commissioner) over whom the commissioners have no formal authority. In addition, a large percentage of the county's resources are allocated to functions such as the public health district, the public hospital, and the public library. Lump sum allotments are made to these organizations and the commissioners exercise no direct control over the organizations. Thus county government is fragmented with little planning or control.

This fragmentation is reflected in the financial system. Financial records are kept in various forms by the clerk of the board of commissioners, the treasurer, and by various major officers. The grand jury, accounting consultants, and the auditor have all recommended a thorough study aimed at revamping the whole system. A partner in the firm which has audited the county's financial records in some recent years said, "There is at present no system of preparing adequate financial reports . . . to permit the governing body to know where they stand."[3]

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[3]Editorial, Augusta Chronicle, August 17, 1971, p. 23.

The county government lacks not only effective systems of financial reporting but also budgeting, internal control, and cash management. The writer's field experiences have shown this general state of affairs to be the rule rather than the exception in Georgia's counties.

The records that are maintained are kept on primarily a cash basis, and not only is depreciation unrecorded, no provision is made for removing the cost or appraisal value of fixed assets sold, traded, or otherwise discarded.

The annual financial report is prepared by the public accounting firm preparing the yearly audit. This rotates between two local firms and so accordingly does the format of the financial reporting. The records of the county are not maintained on a fund basis. The auditing firm attempts through estimates to divide the figures into major funds: General, Public Debt Service, Bond and Pension Funds on the financial statements. Within the last several years since the county tried to install a budget system, comparison of actual and budgeted totals by department total are shown. The statements, as prepared by the auditors, although in what would be considered generally acceptable format, are hampered by the lack of raw data with which to work. For example, only totals by major function are shown for general fund expenditures. No distinction or breakdown is given by cost categories, current or prior year expenditures, capital or operating expenditures. No reasons are provided for variance of actual from budgeted expenditures. The annual audit report-financial statement is

available upon request for review at the court house but no general distribution is made.

(c) Richmond County Hospital Authority

The major community hospital since pre-World War I days has been the University Hospital.[4] The hospital is a large organization serving a multi-county area. The present facility has over 400 beds. A 700 bed facility has just been completed, and plans call for a series of satellite hospitals. In addition to general service beds, the hospital provides chronic and psychiatric treatment wards, obstetrics, pediatrics, a prenatal clinic, physical therapy, a nurse training program, and an emergency treatment facility.

Until 1959 the hospital had been run by the City of Augusta. In 1959 by joint resolution of the city and county governments, a hospital authority was formed and the county government took over the burden of operation. The hospital authority consists of nine trustees appointed for five years by the county commissioners. The Hospital Board is primarily a policy making board which meets but briefly once a month. The actual administration of the hospital is performed by a professional administrator.

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[4] Data on this section was obtained by interview with the hospital administrator, from various county and hospital records, and from the Community Facilities Plan - Hospital, published by the Augusta-Richmond County Planning Commission in 1968.

In return for community medical services (i.e., indigent patient care, emergency room service), the local governments have contracted to provide funds to assure the continuous operation, meet the principal and interest of certain capital debt, and provide funds for expansion of facilities and service. Financial support by the city and county governments run over a million dollars per year out of an operating budget of $7,000,000.

Of all the organizations examined, this unit had by far the most "professional" accounting system. The annual audit and financial report were prepared by a national accounting firm. The annual financial report included a balance sheet, statement of revenues and expenditures, and a statement of changes in fund balances. The accounts were maintained by fund on an account basis. Depreciation was recognized as an expense. The financial reporting generally appeared to be in accordance with the Hospital Accounting Principles promulgated by the American Hospital Association.

Although under Georgia law an audited statement must be filed at the court house yearly, the only report available there was three years old. The flow of financial data between the professional staff of the hospital and the Hospital Authority, the county commissioners, or the public was relatively limited. The general attitude of the professional staff appeared to be: we have to report finances to the federal government (medicare) and Blue Cross; our financial records are audited; as

far as other financial reporting goes we are very busy professionals with many demands on our time.

(d) Richmond County Board of Health

Under the present structure public health services are provided through a joint federal-state-local cooperative plan.[5] The county board of health has responsibility for local programs, activities, and facilities. The local health board serves primarily as a policy making body and consists of local officials and appointees. Under the plan, Richmond County belongs to a multi-county health district. The actual administration of the varied county health programs is under the direction of the professionals of this district organization who supervise a staff of over eighty.

The organization's budget runs over a half million dollars a year. Over 60 percent of the funds come from Richmond County which makes an annual appropriation and is billed monthly. In most instances the financial records of a health district are maintained in the district health offices in the most populous county, i.e., Richmond. Although by law the health district must meet reporting requirements of member counties, the federal and state requirements predominate.

The accounts are maintained on a modified accrual basis. No depreciation is taken. To meet state and federal needs the

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[5]Data on the Richmond County Board of Health was obtained by interviews with the District Health Administrator and various staff members of a number of public health districts; and examination of various county and state records.

accounts are divided into four interrelated sets of accounts (General Health, Mental Health, District, and Home Health). The system is akin to but is not a fund concept. A monthly financial report is prepared by the professional staff and forwarded to the state and the county boards for funding purposes. The report shows expenses by major expenditure item (personal services, travel, equipment, other), less fees collected for the month and year to date.

The primary financial communication between the professional staff and local officials takes place when the annual budget is prepared. The budget must be approved by the local health board, the county commissioners, and the State Health Department. The State Health Department has attempted to implement a planning and programming budget system but has run into many problems.

A considerable number of special reports are required for federal and state programs. These reports are primarily keyed to determining whether funding blocks were spent as allocated. Although considerable operating and financial data is maintained and published on a statewide basis, little communication is effected on a local level. No comprehensive annual reports on a local basis in the form of conventional financial statements are made. Although the local counties provided a majority of the funds and local boards in theory at least made the operating policies, the professional staff saw themselves primarily as state employees not really answerable to the local area.

(e) Richmond County Board of Education

As in most states, the responsibility for the administration and financial support of the public school system in Georgia is divided between the state and local school system.[6] The State Board of Education and State Superintendent of Schools are responsible for formulating and administering broad educational policies and apportioning state funds. The authority and responsibility not specifically delegated to the State Department of Education are vested in the local school board.

Richmond County has a school board of sixteen elected members who act primarily as a policy making body. The actual administration is in the hands of an appointed Superintendent of Schools. The school system is the largest single user of public resources in the county. The school district's budget jumped from $5 million to over $15 million within a ten year period. The school district operates over fifty schools with three thousand employees for over 35,000 pupils.

Over sixty percent of the school district's revenue comes from state and federal sources. As federal and state funding have increased over the years, so have their financial reporting requirements. The State Board serves as a coordinating agency for local school system financial reporting requirements.

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[6]Data in this section was obtained by interviews with state and local school officials and school board members and from review of various state and local documents, particularly the Georgia Accounting Handbook for Local School Systems, prepared by the Georgia State Department of Education.

The Financial Review Section of the State Department of Education has issued a detailed accounting manual for local units. This manual includes a detailed account structure, budget procedures and reporting formats.

The accounts are maintained on a fund structure, but one that differs considerably from that promulgated by the National Committee on Governmental Accounting. The number of funds varies by individual school district from about a dozen to forty.

The reporting format for reports from local to state level are prescribed in great detail. The annual reports running over a dozen pages consists primarily of long lists of categories of revenues and expenditures by fund. The report format is identical with that of the U. S. Department of Education handbooks and is keyed by number to federal account title. The report is in such detail and uses terminology that makes it incomprehensible to anyone not thoroughly schooled with the reporting system.

The financial records are maintained on a cash basis. No depreciation is recorded or reported. The records are audited by both federal, state, and, in some cases, local auditors. Many of the reviews are what most nearly would be considered management rather than financial audits, to determine how particular blocks of funds were spent. In most cases, the financial reporting of the school system to the School Board or the public is limited to data presented during the budget process. The budget is prepared by the superintendent and then

must be approved by the School Board and the State Department of Education. Because of the complexity of the operation, the federal and state requirement for fund segregation and the extent of committed costs, it appears doubtful if anyone other than a few of the professionals can master the intricacies of school finances. Public hearings on the budget are held, however, and often reported in varying detail in the local papers. Considerable operational and financial data is compiled and published by the State Department of Education. Although publications are available on request, no general dissemination of information is made.

(f) Augusta-Richmond County Public Library

The library system provides resources and services to a five county area.[7] The library operates three facilities all in Richmond County and through bookmobiles serves surrounding rural schools and communities. The library has a full time staff of twenty-six. The level of services provided by the library has grown significantly in recent decades. Circulation increased from 65,274 to 695,447 between 1949 and 1967. The Board of Directors of the Young Men's Library Association, a quasi-public organization, is responsible for providing public library services. The chief librarian, appointed by the board,

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[7]Data on the library system was obtained by interviews with library personnel and from various city and county documents.

is in charge of the actual day-to-day administration of the system.

As in the case of the public school system, the library is funded from many sources including fees, gifts, local, state and federal funds. Richmond County's annual appropriation to the library has risen from $73,000 in 1964 to the present total of over $200,000. State and federal aid for libraries is administered through the State Department of Education. Regional libraries meeting certain requirements, as does the Augusta-Richmond County Library, can receive funds for books, salaries, travel and facilities. Local funds provide about three-fourths of a total year's budget.

The financial records are maintained on a modified fund basis. No depreciation is recorded or reported. There are two dimensions to financial reporting in the system. One dimension is to the State Department of Education. This consists primarily of submitting prescribed listings of revenues and expenditures. These reports are primarily designed to reflect utilization of state and federal funds. The other dimension of financial reporting is between the library's professional staff and the Board of Directors. This is done through a monthly treasurer's report. This report shows receipts and expenditures for current month, cumulative to date and as budgeted. Limited breakdowns are shown for major expenditure categories. The records are audited by an independent auditor on a yearly basis.

(g) Augusta Housing Authority

This agency is a combined local-federal agency. The agency provides public housing for the low income and elderly.[8] The Authority has grown from a 168 unit project in 1937 to ten developments with almost 2,500 units and an annual budget of almost a million dollars.

The Board of Commissioners, appointed by the mayor of Augusta, is responsible for the operation of the agency. They are in turn regulated by both state and federal statutes. The commissioners appoint an executive director who administers the program and a staff of eighty-five.

Rental fees charged are limited to a percentage of the resident's income. The federal government subsidizes the cost of yearly operation and the construction of new projects.

The federal government maintains relatively close control over the accounting system. The authority uses a federally prescribed chart of accounts, must have its budget federally as well as locally approved, and must submit periodic reports to the regional office of Housing and Urban Development.

The accounts are maintained and reported on a modified accrual basis. A fund structure is utilized, and no depreciation is recorded. The authority submits a formal annual financial report to the federal government. The report includes both a detailed balance sheet and statement of operating receipts, and

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[8] Data on the housing authority was obtained by interviews with local and federal officials and from various local and federal documents.

expenditures of separate funds are consolidated and no separate fund totals are shown. The statement of operating receipts and expenditures compares budget with actual figures. The authority also prepares an "annual report" for the Board of Directors and local government officials. This includes a financial report. Copies are available for public use, but general distribution is not made. The financial report is a less technical condensation of the reports forwarded to the federal government.

Audit of the financial records is performed by federal auditors. Although annual audits are required, the auditors had not been there for three years.

(h) Public Welfare

Public welfare, although primarily funded from state and federal sources, is administered through and with the cooperation of the county government.[9] Each county has a local Board of Family and Children's Services and a local county director. The director is appointed by the board from a register of qualified applicants. The director is responsible for administration of the four major welfare programs as well as general assistance programs, hospital care for the indigent, and proper burials. The county commissioners provide office space, equipment, supplies, funds for certain services, and in some cases

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[9]Data on the welfare system was obtained by interviews with welfare department personnel and from various documents.

supplement the base salaries of the local professional staff paid by the state.

In Richmond County the program has well over one hundred employees. The total budget for the department runs over $7 million. The appropriation of Richmond County is over $400,000. Almost 10,000 persons in Richmond County receive public assistance in some form.

Complicated funding and accounting arrangements characterize this agency. The local unit determines, under federal and state guidelines, who gets what amount and certifies this to the state unit. The state pays this directly to the client and is reimbursed from the federal government for its share. The local unit's administrative expenses (salaries, travel, etc.) are paid from county funds and then reimbursed by the state which is reimbursed by the federal government.

Local financial records are maintained in some form by both the county clerk and the local welfare unit. The records are maintained on a cash basis and no depreciation is recorded. (Physical assets remain the legal property of the county.) Fund accounting is not used but expenses are segregated by major programs. Detailed listings of expenditures are reported to the state monthly for cost reimbursement.

The financial records are audited by both state and federal auditors. The federal government is now researching a comprehensive management audit system to monitor the effectiveness and efficiency of welfare dollars spent. Neither factor is now shown in the present financial reports.

The local county director prepares an annual report for the board of directors and the county commissioners. The quality of these reports varies widely between counties. The report, which in Richmond County includes receipts by source and expenditure by major program, is available for public inspection but wide distribution is not made. The State Department of Family and Children's Services also prepares an annual report which shows similar data by county for the state as a whole. This is available upon specific request as long as the supply lasts but is not given general distribution.

The organizations reviewed on the preceding pages are the major functional units which operate relatively separate accounting systems. There are also minor units insofar as resources consumed that operates within the county area as relatively independent entities. These include joint city-county units, such as the Augusta-Richmond County Planning Commission; joint local-federal units such as urban renewal; and joint state-local units such as the cooperative agricultural extension service.

In summary it has been shown that a wide variety of accounting principles and practices exist within the local government units in this county area. Some of the major points are highlighted below.

Basis of accounting. The practices range from full accrual (hospital) to modified accrual (city, health department, housing authority) to the cash basis (county, school, library,

welfare). None of the modified accrual practices were identical to each other, and none of the practices matched the procedure recommended by the National Committee on Governmental Accounting. Although the school system and the county kept their financial records on a cash basis, the reports as prepared were modified to reflect selected receivables and payables.

Depreciation. The hospital was the only unit to record depreciation of fixed assets on their financial statements. The school system was required to compute depreciation if certain classes of fixed assets were sold but did not record annual depreciation charges. The county recorded the purchase of physical assets at cost, but did not remove them from the books when they were sold or discarded. A number of units (health, welfare, library) showed no capital assets at all on financial statements. None of the units followed recommendations of the National Committee on Governmental Accounting for recording or depreciating fixed assets.

Fund accounting. Two units (county and welfare) did not keep their financial records on a fund basis. (The county's auditors did attempt to fit the cash basis accounts into a fund format as best they could.) The remaining units used some sort of fund structure. The fund systems that were used differed both from each other and that recommended by the National Committee on Governmental Accounting.

The federal and state governments played dominant roles in prescribing principles and procedures for a number of units

(health, education, welfare). Principles recommended by professional organizations influenced the financial systems in a number of cases, namely the hospital (American Hospital Association), and school (Association of School Business Officials).

An interested citizen or for that matter anyone without considerable specialized training in the field and large blocks of time would have a very difficult time obtaining a comprehensive picture of local government finances in this county area. Not only did the principles of accounting vary between units, they were not clearly spelled out. There was little similarity of terminology or format in the financial reports. In most cases the data needed was not available without considerable investigation.

Although some kinds of local government units such as school districts have been forced into a financial system that is relatively similar on a statewide basis, this is not the case with city and county governments. These particular kinds have been left relatively free in Georgia to develop more or less as they please. The analysis in the next section gives a fairly good indication of the financial reporting practices of local government units that are not controlled by federal or state legislation.

In this portion of the analysis an examination was made of a sample of published financial reports of Georgia's cities and counties. In the investigation performed one hundred annual financial reports, fifty city and fifty county, were chosen at

random from the files of the Georgia State Auditor, the Institute of Government of the University of Georgia and the Georgia Municipal Association.[10] Actual financial reports were utilized in the analysis rather than gathering data by a mail survey. In reviewing similar types of studies done by mail survey the sample returned appears biased by the fact the units with poorer practices in most cases do not return their questionnaire.

Both Georgia's cities and counties are required by law to publish annual financial statements but no standards are set and no state agency is charged with ascertaining that satisfactory financial reports are prepared by each unit on an annual basis. Details of the analysis are reported in Appendix III-F.

The following is a summary of the major findings of the analysis that was performed.

(1) All the reports had been either prepared by an independent auditing firm (96) or if prepared by the unit (4) had been audited. Eighty accounting firms were included in the sample. Ten of the examinations and reports had been done by public accountants (no state license required) and the remainder by auditors with a firm of Certified Public Accountants.

(2) The reporting process in local governments now has as a primary function, a check on financial accountability.

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[10] A listing of the actual cities and counties included in the sample are shown in Appendix III-E.

The audit report in this case forms an integral part of the financial reporting process. This aspect of the report was evaluated against the professional guidelines of the auditors themselves, the Generally Accepted Auditing Standards of the American Institute of Certified Public Accountants:

> The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.[11]

Thirty of the reports stated the financial statements were presented in accordance with generally accepted principles of accounting. Eleven of the reports stated the financial statements were presented in accordance with generally accepted principles of municipal accounting or a similar qualified phrase. This is an alternative practice but considered less desirable. Fifty-nine of the reports made no mention of generally accepted principles of accounting.

> The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.[12]

Forty-four of the reports made reference to the consistency of application of accounting principles. Fixty-six of the reports made no reference to consistency.

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[11] Committee on Auditing Procedure, Auditing Standards and Procedures (New York: American Institute of Certified Public Accountants, 1963), pp. 15-17.

[12] Ibid.

> The report shall either contain an expression of opinion regarding the financial statements taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated.[13]

In only twenty-nine reports did the auditors render an unqualified opinion. The other seventy-one reports had a qualified opinion or no opinion. In thirty-seven of the cases where a qualified opinion was given the reason for the qualification was clearly spelled out; in the remainder this was not made clear.

The auditor, by his own standards, is required to exercise due professional care which includes a proper study and evaluation of the internal control system and examination of sufficient competent evidential matter to form a reasonable basis for an opinion. The recommended language of the standard audit report includes the following statement.

> Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.[14]

Although sixty-seven of the audit reports represented that the examination was made in accordance with generally accepted standards of auditing, thirty-three made no mention of generally

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[13] Ibid.

[14] Ibid., p. 57.

accepted auditing standards. Only forty-six stated they had performed all such procedures necessary in the circumstances. The most frequent omissions given were the confirmation of receivables, lack of fixed asset records, and not verifying the physical inventory.

In a considerable number of cases the auditor did not clearly indicate the extent of his examination. This was particularly a problem in county audits where in thirty-two of fifty reports the auditor did not clarify which funds or offices the audit included. In fifty-two reports the auditors failed to state they had examined the financial statements, but stated they had examined books, records or other similar vague references.

(3) Frequent reference is made in governmental accounting literature to the conflict between legal and "sound" accounting provisions. Only two of the reports mentioned any aspect of legal provisions affecting the accounting system.

(4) Timing of the audit and financial reports varied significantly. Of the one hundred reports: 6 had no date, 13 were dated within 30 days of the end of the period, 32 within a 30 to 60 day period, 17 within a 60-90 day period, and 32 were dated over three months from the end of the period.

(5) Organization of the financial report was often poor. In judging the adequacy of the organization of the financial reports, the guidelines of the National Committee on Governmental Accounting were generally followed. The National Committee

recommends dividing the financial report into three sections as follows:

A. Introduction
   1. Title Page
   2. Table of Contents
   3. Letter of Transmittal

      Includes legal and policy requirements and substantive aspects of the reports such as the basis of accounting, changes of financial policy, and financial problems faced.

   4. Auditors opinion
   5. Optional

      Names of principal government officials
      Unit organization chart
      MFOA Certificate of Conformance

B. Financial Statements
   1. Combined statements and schedules
   2. Fund statements and schedules for individual groups

C. Statistical Section

In judging whether the report was properly organized, the above served as guidelines and strict conformance was not required as long as most of the necessary data was included in a logical manner and the report was adequately indexed and cross references made. Thirty-six of the one hundred reports in the sample were judged to be properly organized. The remainder were deficient in such points as information presented or indexing.

(6) The National Committee on Governmental Accounting recommends the use of four combined statements and three combined schedules to display financial data for the governmental unit as a whole. Only three units in the sample included all of the recommended combined statements in their reports. Sixty-one of

the reports had no combined statements. Of this number though, twenty-nine had included reports on one fund only.

Of the thirty-nine units utilizing combined funds statements, the balance sheet, in thirty-three cases, was the most common combined statement. The National Committee emphasizes that account totals of the various separate funds shown on the balance sheet should not be totaled. Only ten of the combined balance sheets followed this precept, the remainder consolidated the totals by account either vertically or horizontally. This is a practice the National Committee, because of restriction of funds, believes will lead to false inferences. Formats of other combined reports varied similarly from the National Committee's recommendations.

(7) The National Committee represents as an integral part of the financial statement a section of comprehensive statistical data which relate to the physical, economic, social, and political characteristics of the unit. The statistical data are intended to give the user a broader and more complete understanding of the unit and its financial affairs. The National Committee lists seventeen tables as being essential to adequate and full understanding of financial affairs. Only a half dozen units complied at all substantially with these requirements. Although most reports contained statistical schedules of some sort they were usually confined to lists of bonds outstanding, insurance in effect, or lists by name of various payables or receivables. Noticeably absent were multi-year analyses of expenditures and revenues.

(8) Although the NCGA recommends that the letter of transmittal clearly state the basis on which the financial records are maintained, in two-thirds of the reports this point was never made clear. It proved impossible to obtain an accurate picture of the actual practices; they proved so varied and murky. They ranged from full accrual for every fund, to full cash basis for every fund. Less than ten units appeared to comply with the recommendations of the NCGA. The most common reporting mechanism was to take the existing cash basis recording system and modify it for reporting by adding major receivables (Taxes Receivable and Utilities Receivables) and major payables for which an invoice had been received. In most instances it was impossible to determine what system was followed by the unit and what modifications had been added by the auditor.

(9) The NCGA recommends that depreciation be recorded on self-supporting enterprise funds but not on the general fixed assets of a local government. Among the one hundred units, thirty-eight maintained separate enterprise funds. Of these, half, or nineteen, recorded depreciation on these funds. Other units also operated utilities but mingled the accounts with a general fund and took no depreciation. Seven units took depreciation on all fixed assets, general fund included. One report showed a calculation of depreciation for balance sheet purposes but did not include this with the expenses. Generally one gathers from the auditor's comments that the records of

physical assets are very poor and that many units have no comprehensive records in this area.

(10) A cornerstone of effective reporting as set forth by the NCGA is the use of comparative figures. Comparison not only of actual and budgeted but also with prior years and the current year actual is recommended. This was noticeably lacking in financial reports. Only a dozen financial reports used a comparison of actual and budgeted figures. Twenty financial reports used comparisons involving actual and prior period figures. Less than ten made comparison using both actual, prior period and budgeted figures.

(11) The fund structure and their financial reports varied widely. Eleven of the units did not report on a fund basis of any type. Twenty of the units reported but one fund, a general or operating fund. Seventeen units utilized two funds, usually a general fund and a bond fund; and fifty-two units reported three or more funds. Many units combined enterprise, debt and/or general operations under the same fund. Other units particularly counties used the term fund for reporting on particular offices when it appeared as if a separate fund was not actually maintained. Of the eighty-nine units reporting on a fund basis twenty-eight included, for each fund the three basic financial reports, balance sheet, statement of revenues and expenditures and a statement of changes in fund balances. Thirteen were missing one statement, usually the changes in fund balances, and forty-eight were missing two or more statements.

Based upon the analysis performed, the writer's findings can be summarized as follows. Generally the larger population units had more satisfactory financial reports than the smaller units. The larger auditing firms generally produced more satisfactory reports than the smaller firms. (The larger units tended to employ larger firms for their audit.) There were exceptions both ways. The single best audit reviewed was by a CPA in a one-man firm. Many of the CPA auditors who performed the audits and completed the financial reports either ignored or apparently had never heard of the recommendations of the National Committee on Governmental Accounting. Many of the auditors also failed to comply with their professional auditing standards. Often the audits were limited by the terms of the engagement. There was as much variance between the various reports of the various cities and counties as there is between the financial reporting of the various classes of local governments. Because of many factors: timing, lack of proper summarization, limited audit coverage, lack of comparable data with other units, and lack of comparable budget and prior year data of the same unit, most of the financial reports had extremely limited usefulness.

It would appear when left to their own devices cities and counties do not closely follow National Committee on Governmental Accounting Principles, and that the professional accountants advising them virtually ignore them. Furthermore there is no pattern or consistency to the principles that are followed.

What do studies of local government accounting performed in other areas reveal? Do the studies generally support the findings of the survey done of Georgia cities and counties; or is Georgia an isolated example of poor practice? In the next section we shall examine other studies performed of local government finance.

Relevant Studies of Local Government Financial Reporting

This section of the chapter will examine other studies made of financial reporting at the local government level. Although undoubtedly a considerable number of such studies have been performed, relatively few have been published in a form that permits meaningful analysis.

As we have noted in Chapter II, turn of the century reformers, in examination of individual units, found the financial system, and particularly the reporting mechanism, woefully inadequate in local governments. These findings were confirmed by field representatives of the Bureau of the Census, who, when gathering local government financial data, discovered that at best the reporting was a tangled skein.

Although significant progress was reported by reform groups, much of the improvement appears to have been confined to a relatively small number of larger cities. Generally the tide of reform seems to have washed by without creating significant change. Hackett, writing in the early 1930s, found, for example, that:

> The first fact that we are confronted with when searching for recent developments, or any developments, in governmental accounting, particularly that of municipal governments, is the marked absence of any general improvement.[15]

He cites as a basis for his opinion two studies. One study that was done of 56 Illinois cities and another of 27 cities throughout the United States. In both cases he found the financial reports to be inadequate.

As we have noted during the 1930s the Municipal Finance Officers Association, operating through the mechanism of the National Committee on Governmental Accounting, took up and has henceforth carried the banner of improvement in government accounting. Accounts of this progress are published in glowing terms. Studies that have been done of actual financial administration systems or parts of these systems have generally found the progress to be very spotty. Let me cite a few examples.

Rhode Island, in the late 1950s, performed a comprehensive study of their local government financial systems. The study described the financial system as "go-as-you-please" with no established general standards. The study concluded that nowhere were sound overall standards more urgently needed than in the field of municipal finance.[16]

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[15] R. P. Hackett, "Recent Developments in Governmental and Institutional Accounting," Accounting Review, VIII (June, 1933), p. 122.

[16] Edwin W. Webber, "State Supervision of Municipal Finance in Rhose Island," Municipal Finance, XXXVI (February, 1964), p. 108.

Colorado, in the mid 1960s, revised their entire system of state control. They found that over the years their statutes relating to supervision of local finance had become ambiguous and hopelessly scattered. They found the reporting in Colorado local governments to be of "limited usefulness."[17]

Ohio, in the late 1960s, performed a detailed study of their local government accounting system. Researchers found it necessary to overhaul the entire system. The existing system was based on concepts forty years old.[18]

Generally, the findings of such studies have emphasized two points--the inadequacy of the financial reporting and the difficulty in effectively administering state control of local government finance. Usually this type of study has concerned itself with publishing generalizations about the financial system. Rarely have the articles published spelled out the methodology or the findings in any detail.

Two studies have been done in recent years where both the methodology and the findings in some detail have been published. The most ambitious was done of municipalities in Illinois. The other more recent study was based on a smaller national sample. Both studies involved analysis of the published financial reports of cities and towns.

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[17] M. E. Gause, "State Supervision of Local Finance in Colorado," Municipal Finance, XXXVI (February, 1964), p. 97.

[18] Roger Cloud, "Upgrading Uniform Municipal Accounting Systems," Municipal Finance, XLII (November, 1969), p. 81.

Illinois Society Study

In response to a request by the State Auditor of Public Accounts, the Illinois Society of Certified Public Accountants undertook a review of selected 1964 audit reports of cities and villages in the State of Illinois.[19] The reviewers selected 286 reports to cover a wide geographic area and a large number (200) of practitioners. Members of the Illinois Society's Local Governmental Accounting and Practice Review Committees assimilated and summarized the reviews. The review was directed principally toward ascertaining the degree of compliance with the generally accepted standards of reporting and auditing as promulgated by the American Institute of Certified Public Accountants. From these "standards" a checklist was compiled for use in analyzing each audit report.

The general observations of the reviewers are listed in Table 2. Their principal conclusions were:

1. A majority of the reports failed to comply with some of the reporting standards.
2. Many reports failed to present financial information which is deemed important to full reporting to the public as to the stewardship of municipal officials, as well as information of importance to those officials in their administration of the financial affairs of cities and villages. It is probable that many such failures result from inadequacies of the records of the municipalities.
3. The scope and format of the reports varied materially. This posed a serious review problem for us, and would also for your Office, in

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[19] Robert H. White, "Municipal Audit Review," The Illinois CPA, XXX (Spring, 1967), pp. 39-50.

> appraising the quality of reports against any recognized set of standards.[20]

Members of the committee also charged that study revealed two principal deficiencies by the Illinois Society members performing the audits.[21] First that they, the auditors, had failed to keep abreast of changing trends and new developments in this accounting field. Statements on Auditing Procedure No. 33 says in its discussion of the first general standard:

> It should be recognized that the training of a professional man includes a continual awareness of new developments taking place in business and in his profession. He must study, understand, and apply new pronouncements on accounting principles and auditing procedures as they are developed by authoritative bodies within the accounting profession.[22]

The reviewers found that the audit reports utilized language popular twenty to thirty years ago but obsolete today. Second, that the practitioner had failed to prepare properly for a specialized job, the municipal audit. This included becoming familiar in this case with publications of the National Committee on Governmental Accounting and the Illinois Municipal Code (Chapter 24, Illinois Revised Statutes). Failure to do so, it was stated, indicated lack of due professional care.[23]

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[20] Ibid.

[21] Herbert H. Istrow, "Review of Illinois Municipal Audit Reporting," The Illinois CPA, XXI (Spring, 1968), pp. 32-33.

[22] Ibid.

[23] Robert H. Kuhn, "Standards of Reporting as Applied to Audits of Municipalities," The Illinois CPA, XXX (Winter, 1967), p. 22.

TABLE 2

ILLINOIS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS
GENERAL OBSERVATIONS BY THE REVIEWERS[a]

A very high frequency of unfavorable answers were noted by the reviewers especially in the following areas:

1. The auditor failed to state that he has examined the financial statements, but instead states he has examined books, records or other similar vague references.
2. The auditor's report failed to identify which Funds were included in the examination.
3. The auditor's report did not include a reference to generally accepted auditing standards.
4. The auditor failed to state that he has performed all audit procedures considered necessary, without exception.
5. Exceptions to generally accepted auditing standards or procedures were not clearly expressed.
6. The standard short form of accountant's report was not used.
7. Where a qualified opinion was given, reasons were not clearly indicated.
8. The report made no reference to conformance with generally accepted accounting principles.
9. No reference was made with respect to consistency of application of generally accepted accounting principles.
10. The auditor used qualifications such as "subject to," "except for," in such a way as to cast doubt on his opinion.
11. Many reports failed to include balance sheets, statements of revenues and expenditures and changes in Fund balances, for all Funds.
12. Financial statements failed to show budgetary information.
13. The report failed to present information on interfund transactions or balances.
14. Cross-referencing of significant items on financial statements was missing or indicated errors.

TABLE 2 (continued)

15.	Proper Fund segregations were not used as required or as appropriate.
16.	The report failed to include a schedule of legal debt margin.
17.	The report failed to include schedules of assessed valuations, extended levies, tax rates or general tax collections.
18.	Financial statements for Utility Funds did not reflect the application of accounting principles similar to those in private industry for similar operations.
19.	The report failed to include schedules of outstanding tax warrants or bonded debt.

[a]Robert White, "Municipal Audit Review," The Illinois CPA, XXIX (Spring, 1967), pp. 59-60.

The reviewers recommended to the State Auditor that in view of the nature of the findings that an expanded program be initiated by his office to review reports on a continuing basis.

North Texas State Study

In this study the researchers, both professors at North Texas State, made an analysis in 1967 of the financial reports of 64 cities in 33 states.[24] The study concentrated on four areas of municipal reporting:

[24]Goyne A. Robanson and L. Paden Neeley, "Financial Reporting in Municipalities," Management Accounting, LI (March, 1970), pp. 95-96.

(1) Type and distribution of municipal reports--They found 91 percent of the cities prepared only one report for both management and the citizenry. Only ten of the cities, submitting one basic annual report, prepared a separate report in condensed form, in lay terms for citizenry.

(2) Accounting method used--They found 28.4 percent of the reports did not even disclose their accounting method. Of those making the disclosure 64 percent used the modified accrual method.

(3) Financial statements included in the reports--The researchers as per the attached Table 3 determined the number and percentage of municipalities including each of four basic statements in their annual report by fund. The number of cities failing to include a balance sheet in their annual report ran from a high of 51 percent in Special Assessment Funds to a low of 18.8 percent in General Bonded debt. Even for the General Fund, 22.6 percent did not include a balance sheet. The same types of findings were also revealed for the other statements.

(4) Types of audits and opinions rendered--They found one-fifth of the cities reporting did not have an audit for the year being analyzed. Of those audited, 21 percent of the audits were qualified.

The researchers concluded that "The study obviously revealed major deficiencies in financial reporting by municipalities.[25]

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[25] Ibid., p. 46.

TABLE 3

MUNICIPALITIES INCLUDING FINANCIAL STATEMENTS IN THEIR ANNUAL REPORTS[a]

	Column I				Column II				Column III				Column IV			
	Balance Sheet				Analysis of changes in unapp. surplus				Statement of revenue				Statement of Expenditures			
	Included		Excluded		Included		Excluded		Included		Excluded		Included		Excluded	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
General Fund	41	77.4	12	22.6	38	71.7	15	28.3	47	88.6	6	11.4	46	86.7	7	13.3
Special Revenue fund	33	62.3	20	37.7	26	39.0	27	51.0	36	68.0	17	32.0	36	68.0	17	32.0
Special assessment fund	26	49.0	27	51.0	16	30.1	37	69.9	23	43.3	30	56.7	23	43.3	30	56.7
Bond funds	43	81.2	10	18.8	25	47.2	28	52.8	33	62.2	20	37.8	33	62.2	20	37.8
Sinking funds	29	54.8	24	45.2	17	32.0	36	68.0	25	47.2	28	52.8	25	47.2	28	52.8
Trust and agency funds	38	71.7	15	28.3	18	34.0	35	66.0	32	60.3	21	39.7	32	60.3	21	39.7
Utility funds	40	75.4	13	24.6	37	69.9	16	30.1	41	77.3	12	22.7	41	77.3	12	22.7
General fixed asset Group of accounts	38	71.7	15	28.3	23	43.3	30	56.7	2	3.7	51	96.3	2	3.7	51	96.3
General bonded debt & interest group of accts.	43	81.2	10	18.8	10	18.8	43	81.2	4	7.5	49	92.5	4	7.5	49	92.5
All funds	38	71.7	15	28.3	8	15.0	45	85.0	26	49.0	27	51.0	26	49.0	27	51.0

[a]Robinson and Neeley, "Financial Reporting," p. 46.

The researchers also drew some interesting conclusions on the Certificate of Conformance awarded by the Municipal Finance Officers Association:

> The Municipal Finance Officers Association certificate of conformance appears to be granted for almost any kind of report. . . . there appears to be some doubt as to the long range benefit of this certification program if the certificate is automatically received every year once it has been granted.[26]

Henke and the American Accounting Association's "Not-For-Profit" Committee both were critical of current financial reporting practices in nonprofit organizations. Neither study, however, clarified the depth or method of examination. Henke noted,

> Accounting reports too often have been neither consistent nor logical . . . reports of revenues and expenditures appear to lack objectivity and fairness. . . . Financial statements sometimes seem incoherent, improperly organized, and not articulated.[27]

The American Accounting Association Committee's conclusions, as noted, were of the similar vein of lack of relevance and freedom from bias.

What of the states that have enacted statewide systems of control over the reporting of local governments. Is this the answer to effective local government financial reporting? In the next section of this aspect of local government, accounting is reviewed.

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[26] Ibid.

[27] Henke, "Accounting," p. 9.

Intergovernmental Control of Local Government Accounting

Reformers at the turn of the century were almost unanimous in the opinion that if an effective local government financial administration system was ever going to be possible, it must be acccompanied by some state controls.

> Uniform standards, however, are impossible of attainment except as the result of the existence of a central control. . . . In my opinion central control of municipal accounts is the most important administrative reform which can be secured. For it is only through some such kind of control that uniformity of accounts and records can be secured.[28]

State control of local government financial administration also had advocates among those who, looking at cities, saw them as incapable of effective self government. Commons, a political scientist, in a widely quoted article wrote,

> . . . the heterogeneous alien population in many American cities furnishes a majority of voters. The ignorant, foreign, unpropertied, and corrupt elements are as yet too powerful in America to be trusted with unrestricted local rule.[29]

Commons advocated that a State Auditing Department be formed with power to prescribe a system of local government accounting, examine local records without notice, and prepare comparative financial reports.

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[28]Frank Goodnow, "The Administrative Aspects of State Central Control," Proceedings of the National Municipal League-1905 (Philadelphia: National Municipal League, 1905), p. 254.

[29]John R. Commons, "State Supervision of Cities," Annals of the American Academy of Political and Social Science, V (May, 1895), p. 866.

In some states also the motive for state control arose through concern in overseeing local collections of property taxes due the state. Through state supervision an attempt was made to correct faulty conditions out of which poor tax collections arose.[30]

As had happened in other areas, the reformers of this period looked initially to England as an example of what should be done. In 1871 the English Parliament had passed an act creating a Local Government Board. This law gathered together scattered superintendence of local affairs into one central board.

> English Local Government Board exercises supervisory control over all cities of Great Britain . . . has power to compel and does compel a uniform method of municipal bookkeeping . . . and the fullest publicity regarding all expenditures of public moneys . . . Altogether, it is one of the most important organs of government in Great Britain.[31]

Many of the originally proposed legislative reforms in the United States involving state control were patterned after this example.

One of the first instances of state control of local financial administration occurred in 1878 in Minnesota when an office of State Examiner was created. His duties were to examine affairs of county officers and report to the governor. North

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[30]A. H. Hillhouse, "State/Provincial Supervision of Municipal Finance," Municipal Finance, XXXVI (February, 1964), p. 91.

[31]Fredrick A. Hollis, "State Boards of Municipal Control," Proceedings of the National Municipal League-1896 (Philadelphia: National Municipal League, 1896), p. 229.

Dakota and South Dakota passed similar acts shortly after they were admitted to the Union. This legislation gave these state officers no effective jurisdiction over local government accounting or reporting, but did create a monitoring process. These early acts did not appreciably affect the local government accounting reform movement, except to serve as a sign of encouragement.

Among the more established states, Massachusetts in 1879 passed an act placing accounts of certain county officers under state supervision. In 1887 this act was widened to provide for compilation of the material parts of the returns of county officers in tabular form. Wyoming in 1890 and 1891 passed legislation providing for a comprehensive system of central audit and supervision by a state examination of all municipal corporations. This legislation is regarded by historians as an important step toward comprehensive state control.

Heavily influenced by efforts of the National Municipal League and other reform groups, state control became increasingly popular. Ohio, in 1902, established a bureau for the supervision of the accounts of cities, counties, townships, villages, and school districts. It was termed "the first state to take comprehensive action toward securing uniformity in municipal accounts and reports."[32] Massachusetts followed with similar but

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[32]Charles Gettemy, "The Standardizing of Municipal Accounts and Statistics in Massachusetts," Proceedings of the National Municipal League-1910 (Philadelphia: National Municipal League, 1910), p. 230.

much milder act in 1906 and Indiana in 1909 passed an act closely following the Ohio law.

Two general types of state control agencies have evolved over the years: (a) primary--usually an accounting agency to which financial functions are delegated, and (b) secondary--agencies which perform kindred finance functions such as passing on legality of bond issues. Table 4, below, shows the dates of establishment of fiscal control agencies through the 1920s.

TABLE 4

ORGANIZATION DATES
STATE AGENCIES FOR LOCAL GOVERNMENT
FISCAL CONTROL[a]

Years	Primary	Secondary
Prior 1901	6	1
1901 - 1905	3	-
1906 - 1910	13	1
1911 - 1915	15	7
1916 - 1920	5	6

[a]Wylie Kilpatrick, State Supervision of Local Finance (Chicago: Public Administration Service, 1941), p. 2.

Surveys have shown that today most states supervise the accounting for one or all classes of local government. The nature of the state supervision varies widely. In one state, record systems for all types of local units may be prepared. In another state the supervision is confined to suggestion of a few bookkeeping records for counties. Usually the large number of local units and limited state staffs have prevented

successful implementation of any statewide systems. Relatively few states set forth the principles of accounting that must be followed. Those that do usually refer to the standards set by the National Committee on Governmental Accounting.

The most comprehensive current tabulation of the status of state control is maintained by the Municipal Finance Officers Association. The results of their most recent survey performed in 1969 are summarized below.

California--Has several acts relating to accounting and reporting by various types of local governments. Acts are implemented through use of committees composed of representatives from the local governments affected (school districts, counties, municipalities), and the California Society of C.P.A.s. Administered through the Division of Local Government Fiscal Affairs, Office of the State Controller, State of California, Sacramento.

Colorado--Act adopted in 1965 requiring uniform accounting for cities, counties, and other local governments. Administered by the State Auditor.

Connecticut--Has had acts applying to local government accounting since 1925 and which have been amended from time to time as deemed necessary. Administered by the Municipal Division of the State Tax Commission, State of Connecticut, Hartford.

Illinois--Has compulsory audit act relating to municipalities only. As a result of this act, however, uniform accounting has been stimulated. Accounting manuals, system of accounts, etc., have been prepared for use by local governments. Auditor of Public Accounts, State of Illinois, Springfield.

Indiana--First act adopted in 1909. Applicable to all local governments. Administered by State Board of Accounts, State of Indiana, Indianapolis.

Iowa--First act relating to accounting adopted in 1906. Requirements generally applicable to all municipalities. Administered by the Department of Municipal Finance and Accounting, Office of State Auditor, State of Iowa, Des Moines.

Kansas--Has compulsory audit, budget and local finance acts. First act effective in 1935. Administered by Director, Department of Post-Audit, State of Kansas, Topeka.

Kentucky--Prepared "Uniform System of Accounts for Counties" in 1961. Department of Finance, Commonwealth of Kentucky, Frankfort. Manual for cities prepared in 1968, refers to MFOA and NCGA.

Louisiana--Has a compulsory audit act applicable to local governments which does affect accounting. Supervisor of Public Funds, State of Louisiana, Baton Rouge.

Maine--Act adopted in 1932. Applies to all municipalities. Administered by Municipal Division of the State Department of Audit, State of Maine, Augusta.

Maryland--Has a uniform reporting act applicable to local governments. Fiscal Research Bureau, State of Maryland, P. O. Box 231, State Treasury Bldg., Annapolis, Md. 21404.

Massachusetts--Has had an act relating to municipal accounting since 1910. Applies to all local governments. Division of Accounts, Department of Corporations and Taxation, Commonwealth of Massachusetts, Boston.

Michigan--Act adopted in 1967 required uniform accounting for counties. An act adopted in 1968 required uniform accounting for cities. These acts specify use of NCGA publications.

Minnesota--Act first adopted in 1939. Amended so as to provide for increased cooperation between state examiner's office and Minnesota Society of C.P.A.s. Committee of local and state officials and of the Society has prepared a standard account classification and is working on other revised and recommended procedures.

Mississippi--Act adopted in 1960 aimed at uniformity. Department of Audit, State of Mississippi, Jackson.

Nevada--Adopted a budget act in 1965 that not only relates to budgeting but also requires uniform accounting.

New Hampshire--Act adopted in 1917. Supervision exercised by the Division of Municipal Accounting, State Tax Commission, State of New Hampshire, Concord.

New Jersey--Act first adopted in 1918 and has been amended, some amendments as recently as 1961. Division of Local Government, Treasury Department, State of New Jersey, Trenton.

New Mexico--Act first adopted in 1923; comprehensive amendments in 1938. State Comptroller, State of New Mexico, Santa Fe.

New York--Supervision over accounting began in 1903 but became a major activity in 1943. Applies to all but Buffalo, New York City and Rochester. Various manuals prepared for different levels of government--villages, cities, towns, counties. Division of Municipal Affairs, State Controller, State of New York, Albany.

North Carolina--"Local Government Act" contains a number of provisions bearing on accounting, auditing and related subjects. "Municipal Accounting Manual," prepared in 1961. Accounting Advisory Section, North Carolina Government Commission, Raleigh.

Ohio--Act first adopted in 1902. Applies to all local governments--villages, counties, cities. Municipal Division, State Auditor's Office, Columbus. Manual revised in 1968 and is based on NCGA recommendations.

Oregon--Act first adopted in 1929. An act adopted in 1935 stipulated preparation of a uniform accounting system to be compulsory for use by municipalities. "Compulsory" feature has not been rigidly enforced. Secretary of State, State of Oregon, Salem.

Pennsylvania--Accounting manuals and suggested procedures have been prepared but not compulsory. Bureau of Municipal Affairs, Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg.

Rhode Island--Act first adopted in 1929 but additional acts have been adopted since then including one requiring compulsory audits. Uniform accounting not fully implemented. Division of Local and Metropolitan Government, State of Rhode Island, Providence.

South Dakota--Act adopted in 1943; compulsory for cities over 5,000 population and "voluntary" for those under. Department of Audits, State of South Dakota, Pierre.

Tennessee--Municipal Technical Advisory Service, Service of Extension, University of Tennessee, has prepared account classifications and manuals for use by municipalities. Service is free to municipality requesting it.

Utah--Has a "Municipal Fiscal Procedures Act" and other legislation relating to uniform accounting and auditing, adopted in 1961. One of the most comprehensive pieces of state legislation dealing with the subject. Covers budgeting, uniform accounting, debt, tax matters, etc. State Auditor, State of Utah, Salt Lake City.

Vermont--No formal system but State Auditor, State of Vermont, Montpelier, may make recommendations. Since he is responsible for auditing local governments, generally his suggestions are followed.

Virginia--Act adopted in 1931. Approximately one-half of the cities have had state installations with the remainder basically following state recommendations. Auditor of Public Accounts, Commonwealth of Virginia, Richmond.

Washington--Has had an act since 1909. New classification and instructions issued in 1951 basically predicated on National Committee on Governmental Accounting recommendations. Division of Municipal Corporations, State Auditor, State of Washington, Olympia.

Wisconsin--Some services began on a request basis in 1911. Current and expanded program initiated in 1940. Department of Audit, State of Wisconsin, Madison.

Wyoming--First act relating to municipal accounting adopted in 1890. Generally uniform throughout the state. State Examiner, State of Wyoming, Cheyenne.

Based upon the surveys that have been made and after reviewing the statutes of many states that control in some measure the financial administration of their local governments, this writer's general observation is that, although state supervision exists in a considerable number of states, it generally has proven of limited effectiveness. The confusing manner in which control is administered and statutes written and indexed makes it relatively impossible for a mail type survey to be performed which gives a clear picture of the problem area. State statutes or administering agencies have generally not been so explicit as to set forth specific principles to be followed.

Where details of the accounting system have been mandated by statute, the effectiveness of state control and the quality of financial reporting have suffered from rigidity.

> State systems too often have remained static once they were prepared, so that improvements in accounting techniques at times went beyond state-prescribed records. . . Too often in the past the state has sought to force on local offices accounts and forms that would help state auditors but which failed to afford an accounting basis for local supervision.[33]

On the other hand, where details of prescription have been left to a particular state officer, results have varied widely with the professional competence, resources, and interest of the particular office holder.

On the whole the writer is inclined to believe that the most satisfactory solution is to charge a fairly high level state officer with the authority and responsibility to see that effective local government financial reporting is accomplished. Perhaps the best example of this is the Ohio system.

Under the Ohio constitution the State Auditor was given the responsibility of prescribing a uniform system of accounting and reporting for Ohio's cities and villages. The existing regulations had not been revised in over 40 years and were inadequate for today's needs. The State Auditor in 1968 set up a task force of state and local government officials

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[33]Kilpatrick, State Supervision, p. iv.

and consultants to develop a uniform accounting system. The study completed in 1969 resulted in an accounting manual for the guidance of Ohio's cities and villages to guide their financial accounting by. The manual draws heavily from publications of the National Committee on Governmental Accounting and refers directly to the accounting principles promulgated by that body. The manual tries to set out as mandatory only those guidelines essential for compliance with state law. Local systems are encouraged to develop a system to their specific needs. An optional model of good practice is provided for those that need guidance. To insure compliance with the law a comprehensive financial report roughly similar to that recommended by the National Committee on Governmental Accounting must be completed by each local government and forwarded to the State Auditor annually.

The controls of the federal government on local government accounting appear to have had a more significant impact when applied than those of the state. As our federalistic system evolved the federal funding of special function local government units has become more common, and with funding has come control. The power of the purse soon manifested itself in accounting controls. As we have noted earlier in this chapter the federal government in certain agencies of local government is the dominant factor. Usually they have not been satisfied with broad guidelines but have prescribed required finance systems down to the level of providing required finance

systems down to the level of providing a chart of accounts and specific report formats. They have enforced this by periodic audit and by the threat of withholding funds. Sometimes as we have noted they deal directly with the local unit and sometimes the state acts as the middleman and shares in the prescription and enforcement. In these cases the financial reporting system that has resulted has usually been keyed to the needs of the fund granting agency in determining how a particular fund block was spent. In most cases specific sets of accounting principles have not been set forth, the needs of other users of the financial report have not been taken into account, and varying agencies have not coordinated their approach.

Summary

Local government in our federalistic system has evolved into a complex network of both single function and multi-purpose organizations. The network results in complex relationships for planning, control, and funding. Within a single county area a dozen or more public and quasi-public organizations utilize public resources, provide services to the public, and are subject to varying degrees of local control.

This chapter has presented an evaluation of the state of financial reporting and the accounting principles followed by local government organizations. Although the evidence available is not conclusive, it is convincing on a number of points on

characteristics of the local government financial reporting system.

Perhaps the most striking characteristic of local government financial reporting is the variety with which one is confronted. In the study of a model county area in Georgia, we found that reports for each different organization class differed from that of other organizational classes. Organizations which depended heavily on intergovernmental funding, such as school districts, were found to have similar financial reports between units of the same class throughout the state. There is in most instances little coordination between funding agencies at the state and federal level. The result is that reporting will differ considerably between classes of organizations even though both received reporting prescription from federal or state levels.

Multipurpose local government agencies in Georgia, city and county governments, had no effective intergovernmental regulation of financial reporting. The analysis showed that where financial reporting was not controlled, wide variety in financial reporting existed between units of the same class.

The reports differed between and among classes in a number of ways. The reports varied widely in format, including titling, physical arrangement, and summarization techniques. The principles applied to reporting varied widely including such major areas as the basis of accounting, and accounting for fixed assets. The terminology varied widely between reports. Single function units also tended to develop a special

terminology set relatively incomprehensible to those unfamiliar with the field.

In most cases organizations failed to follow the principles of the National Committee on Governmental Accounting. These principles seem to have been ignored both by federal and state agencies prescribing for local governments and by public accountants preparing financial statements for cities and counties.

This finding of the analysis of Georgia was confirmed by the Illinois study. One of their principal conclusions was that the reports varied so materially in scope and format that it posed a serious review problem in appraising the quality of reports against any recognized set of standards.

The writer has found that large cities (over 100,000 population), regardless of location, tend to conform most closely to the principles and reporting standards of the National Committee on Governmental Accounting. There are, however, only 130 such cities in the United States out of 81,299 local government units.[34] When an author writes of the marked improvement of local government reporting and its increasing conformity to NCGA principles, in most cases he is probably referring to this extremely limited subset.

A second evident characteristic noted in the analysis of financial reporting of Georgia local governments was the relative

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[34]U. S. Bureau of the Census, Census of Governments, 1967, Vol. 1, Government Organization, (Washington, D. C.: U. S. Government Printing Office, 1968), pp. 1-2.

incompleteness of the reports. This incompleteness took two forms. First, numerous financial statements, both combined statements and statements for individual funds, as well as basic statistical tables, had not been included in the financial reports. Second, many of the financial statements that were made lacked necessary data, such as comparative prior year or budgetary figures.

This conclusion is borne out by both the Illinois and North Texas State study. The Illinois study noted that many reports failed to include basic financial statements, failed to show budgetary information and failed to show information on interfund transactions. The North Texas State study found that in all funds a relatively high percentage of units failed to include one or more basic financial statements.

The third notable characteristic of local government reports is what I shall term their "unprofessional" character. This term covers a variety of ills.

The fund concept has been in existence for many decades. In the analyses of financial reports of Georgia local governments, it was obvious that many preparers of reports had no idea of accepted good practice when reporting by fund. This point was raised in the Illinois study as well; where it was noted that proper fund segregations were not used as required or as appropriate.

In many cases in the analysis of Georgia local governments indexing and cross referencing were either missing entirely or

noticeably deficient. A similar finding was made in the Illinois study.

Proper summarization of data by like kinds to permit meaningful analysis is a keystone of good financial reporting. Many of the reports failed to use proper summarization techniques. Particularly deficient was a separation and summarization of capital versus operational expenses. Expenses instead of being summarized by category were often listed by persons to whom the check was made payable with little indication of what the expense type was. In consolidated statements restricted and unrestricted assets were consolidated providing an erroneous picture.

CHAPTER V

LOCAL GOVERNMENT ORGANIZATION AND FINANCIAL REPORTING

In this chapter three interrelated facets of local government accounting are reviewed and analyzed. Discussion of these points is necessary to round out the background provided for the reader on the problem area, and to provide information to aid in evaluation of the conclusions and recommendations presented in the next chapter.

Local government accounting "theorists" have long maintained that certain organizational characteristics of local governments account for much of the differentiation between the accounting systems of public and private organizations. The first section of this chapter presents a review of the major arguments offered by proponents of this line of reasoning.

The second section of the chapter reviews the major differences between the financial reporting principles practiced and followed in local government organizations as opposed to those utilized and recommended for firms in the private sector.

What are financial reports of local governments used for? A major criticism of the existing financial reporting system is that even if the reports follow the recommendations of the

National Committee on Governmental Accounting they still are not quite capable of providing the information needed to satisfy the demands of today's society. The third section of this chapter will review the major purposes for which local government financial reports are utilized and evaluate their effectiveness in meeting user needs.

The last section of this chapter provides as a summary presentation a case study of financial reporting in an urban county. The presentation underscores the importance of local government financial reporting, illustrates the actual uses such reports are put to, and highlights some of the shortcomings of the existing reporting system.

Organizational Characteristics of Local Government

Since authors at the turn of the century started to write seriously on the subject of government accounting and to set forth model systems, a point of controversy has developed over the extent to which the organizational characteristics of government units differ from those of private businesses. These differences have been used as a primary justification for the variances that exist between the accounting systems of public and private organizations. The main arguments are summarized below.

The most frequent organizational differentiation made is that local governments lack the profit motive of private businesses. This argument takes several forms. One variation is

that local governments lack the "profit yardstick" with which to measure either organizational or individual performance. This is used as an explanation for the local government financial reporting techniques of measuring expenditures against appropriations. Other authors characterize local governments as public service producing agencies. This argument often stresses that there is no direct relationship between services provided and the revenue that funds them. This is often used as a basis for justifying financial reports on a nonaccrual basis where no attempt is made to match revenue with expenses in a particular period. Finally it is stated that ownership as it exists is in common, not represented by individual shares to which profit accrues and which cannot be sold. This is cited as a justification for the treatment accorded general government assets and the recording of equity as it is practiced.

Government operations are frequently said to be more diverse than those of private firms. This of course depends on the type of local government. The term "more diverse" is relative. Few local governments are as diverse as today's large conglomerate corporations. Yet a relatively small number of businesses engage in operations of the variety and complexity of even a medium-sized city. The operations of many municipalities include administering and accounting for everything from abattoirs to zoos and from jet airports to ocean ports. This diversity is used as one of the justifications for the fund concept, with separate activities, in effect, acting as quasi

independent entities within a larger organization. Large corporations have also been forced to decentralize management and accounting operations. They have not resorted to a fund accounting approach but they have experienced difficulty in preparing meaningful consolidated financial reports.

Local government accounting is subject to rigid and often complex legal requirements and restrictions. Private firms, while of course subject to varying government regulations, tend to develop their operational methodology in relative freedom. Regulation of local government as we have seen varies from state to state and within states by type of local government unit and sometimes even by population class. The regulations imposed vary from requiring that certain funds be used or that an annual financial report be posted on the courthouse door, to prescribing details down to the chart of accounts and exact report formats. The primary thrust of regulation has been control of resources. This argument is used as a justification for fund accounting and inclusion of budgetary figures on the books of account.

Important aspects of the local government accounting function are administered by personnel without proper qualifications.

> The pattern and quality of government are strongly affected, probably adversely, by the methods of selecting persons responsible for it. In business ability, training, experience, and other constructive qualifications are generally the determining factors in selection of personnel. In governmental practice, on the other hand, offices involving important

> accounting functions often have only the most superficial qualification requirements, such as citizenship, residence and age.[1]

Here the writer can only give his own impression. Generally for the size and complexity of the organization and the amounts of resources they are allocated, local government units do not have accounting personnel either in number or qualifications that good management practices dictate. Generally the jobs are relatively low paying and are held by persons with minimum qualifications. In smaller units the accounting duties that are performed are just part of varied tasks performed. The net extent to which local governments and comparable private organizations differ in this matter is not measurable.

This argument is often advanced as an apology for the use of single entry or cash basis accounting systems. The system must be kept simple so that the recorder can master its dimensions.

Upon examination the question appears to be not whether there are some differences in organizational characteristics. Few would argue there are not. Rather the question is, are the individual differences so dominant that they interact to give local governments as organizations a uniqueness that justifies the varying accounting treatments that have evolved.

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[1] R. M. Mikesell and Leon E. Hay, Governmental Accounting (Homewood, Illinois: Richard D. Irwin, Inc., 1961), p. 7.

In the next section of this chapter, we shall look at the controversial practices of local government accounting. Primarily, controversy has arisen where practices in public and private organizations vary.

In the next subsection, the major points of controversy are examined. In each case, the issue will be defined, the development of the concept traced, the arguments for and against presented, and the consequence of existing practice discussed.

Accounting Characteristics of Local Governments

Depreciation

In most local government units, fixed assets make up a large percentage of the organization's total resources. This may vary of course from agencies which utilize relatively few fixed assets and serve primarily as a conduit for dispensing of funds from other levels of government to a city or county government that expends millions of dollars for fixed assets to provide local government services. The problems of accounting for fixed assets has become increasingly important as the competition for capital project funds heightens; and as the scale of investment in fixed assets necessary to provide the expanding local government service program rises.

The accounting for fixed assets and particularly the appropriateness of depreciation for local government organizations is one of the most controversial problem areas in the whole field. The objective of depreciation accounting is "a

priced allocation of the expiration of service potentials (assets) over accounting periods benefited."[2] Failure to account for depreciation represents a major departure from the principles of accounting generally accepted in the private sector.

Fixed asset accounting and particularly the subject of depreciation has been among the most discussed topics in accounting. When local government accounting was starting its development, as a more or less distinct field, at the start of the twentieth century, the depreciation question in general was not resolved. In the initial writings of the turn of the century local government accounting reform groups, such as the National Municipal League, specific attention was not focused on fixed assets or depreciation. The accounting-reporting systems as presented were generally not that detailed or sophisticated; and it appears the writers assumed that prevalent commercial practices of the time would be followed.

Even at this early date, variations in actual practice can be noted. The firm of Haskins and Sills, for example, at the turn of the century was engaged by the City of Chicago to install and supervise a new system of accounts. The system they devised was described as ". . . a masterly piece of work [which] will serve as a milestone in the movement toward municipal reform."[3] The proposed balance sheet as illustrated in

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[2]Committee on Accounting Practice of Not-for-Profit Organizations, "Not-for-Profit," p. 116.

[3]Cleveland, Chapters, p. 242.

Table 5 attempted to group like kinds of assets and liabilities to provide accounting information at a time when the concept of liquidity was still in a formative stage. Fixed assets were accounted for on the balance sheet as assets not available (not liquid).

Financial reporting for fixed assets in New York City took a different approach. The Handbook of Municipal Accounting, published by the Bureau of Municipal Research in 1913, advocated splitting the accounts between a current and capital balance sheet to give a "better view" of the financial picture. The Handbook recognized:

> The municipality has another important category of assets and liabilities; namely, those relating to the equipment, plants and other properties acquired and maintained by which public service is performed.
>
> . . .
>
> These assets and the liabilities incurred in acquiring them are obviously in a distinct category from those relating to operation. For this reason, they are best exhibited in a separate statement. This statement . . . we call a capital account balance sheet.[4]

Table 6 shows the illustration appearing in the Handbook for a capital account balance sheet. This combined permanent properties and current assets committed in new projects in the same statement as construction-related liabilities. This was a controversial practice even then.

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[4]Bureau of Municipal Research, Handbook of Municipal Accounting (New York: D. Appleton and Company, 1913), p. 43.

TABLE 5

Outline of a System of Accounting Proposed for Chicago by Haskins and Sells[a]

ASSETS

1--AVAILABLE
- (a)--Cash with Treasurer
  Divided between the cash for general purposes and the cash for specific purposes.
- (b)--Petty cash
  Specifying the bureaus holding same.
- (c)--Taxes current and arrears in detail.
- (d)--Other assessments current and in arrears in detail.
- (e)--Other accounts receivable.
- (f)--Other available assets.

2--WORKING AND CONTINGENT
- (a)--Material and supplies.
  Divided between the different bureaus.
- (b)--Norwood Park tax certificates.
- (c)--P. Redieski's (ex-Town Collector) shortage.
- (d)--Special assessments current and in arrears.
- (e)--Other working and contingent assets, in detail.

3--DEFERRED
- (a)--Sinking funds.
- (b)--Other deferred assets.

4--NOT AVAILABLE
- (a)--Real estate
  Details of all real estate should be kept in a sub-ledger.
- (b)--Buildings, including furniture, fixtures, heating apparatus, and equipment. Details of each building should be kept in a sub-ledger.

4--(Continued)
- (c)--Water works plant
- (d)--Electric light plant
- (e)--Fire Department apparatus
- (f)--City telegraph and fire alarms
- (g)--Libraries
- (h)--Other assets not available

LIABILITIES

1--DEFERRED
- (a)--Bonds
- (b)--Water certificates
- (c)--Judgments
- (d)--Interest accrued but not due
- (e)--Trust funds
- (f)--Reserve due contractors
- (g)--Other deferred liabilities

2--FLOATING
- (a)--Interest due not paid
- (b)--Bills payable
- (c)--Vouchers unpaid
- (d)--Payrolls unpaid
- (e)--Other accounts payable
- (f)--Other floating liabilities

3--CONTINGENT
- (a)--Water pipe extension certificates
- (b)--Special assessment obligations
- (c)--Sinking funds
- (d)--Other contingent liabilities

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[a]Haskins and Sells, The Accounting Method of the City of Chicago, (Chicago: Haskins and Sells, 1901), pp. 100-101.

TABLE 6

SAMPLE CAPITAL ACCOUNT BALANCE SHEET[a]

CITY OF NEW ROCHELLE, N. Y.
Balance Sheet as at December 31, 1910--Capital Account

ASSETS

Cash		$ 279,304.79
Assessments receivable:		
Sidewalk	$ 37,886.67	
Sewer	61,932.54	
Paving	31,297.23	131,116.44
Local improvements in progress		91,866.43
Lands, buildings, equipment, and other permanent improvements		2,588,346.82
Total assets, capital account		$3,090,634.48

LIABILITIES AND SURPLUS

Audited vouchers payable		$ 3,000.00
Certificates of indebtedness issued for:		
Sidewalk improvements	$100,000.00	
Sewer improvements	93,062.20	
Street paving improvements	37,000.00	230,062.20
Certificates of indebtedness issued for construction		26,252.82
Bonded debt	$2,499,658.46	
Less sinking fund cash	78,267.80	2,421,390.66
Surplus--Cash over immediate demand for cash	$ 276,304.79	
Surplus--Properties and other assets over certificates of indebtedness and net funded debt	133,624.01	
Total surplus, capital account		409,928.80
Total liabilities and surplus, capital account		$3,090.634.48

[a]Bureau of Municipal Research, Handbook of Municipal Accounting (New York: D. Appleton and Company, 1913), p. 44a.

Generally the literature published until the 1920s did not advocate accounting for the fixed assets of government entities in a manner significantly different from those of private businesses.[5]

Even the Handbook did not look upon the methodology they recommended as a distinction occasioned by the fact the corporation was a municipal one. In practice the splitting of balance sheets paralleled the English Double Account Balance Sheet of parliamentary companies. The Handbook pointed out:

> The differences between private and public accounting are not differences in purpose or differences in method, they are differences in the subjects concerning which information is needed.[6]

Works published after the 1920s started to take a different tack. Part of this was due to the inclination of writers to differentiate governmental accounting as a separate subfield, but certain other factors also affected specifically the development of the accounting for fixed assets. There appears to have been early difficulty in distinguishing between a fund and a reserve and some critics advocated not recording depreciation unless replacement was funded. There was some confusion over whether the recording of depreciation and debt

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[5]See also W. A. Paton and R. A. Stevenson, Principles of Accounting (Ann Arbor: The Ann Arbor Press, 1916), p. 216; and D. C. Eggleston, Municipal Accounting (New York: Ronald Press Company, 1914), p. 33-4.

[6]Bureau of Municipal Research, Handbook, p. x.

service didn't result in double charging the taxpayer. As the use of budgets grew, procedural problems arose in handling of depreciation as an expense without having an expenditure.

Because of such factors and the desire to develop a specialized field of governmental accounting, some accountants advocated that expenditures for fixed assets be expensed as incurred and not recorded on financial statements. Francis Oakey, the Chief Consulting Accounting to the Institute for Government Research, in a widely circulated text summarily concluded in a review of accounting for fixed assets that the reasons a private enterprise included the value of permanent properties in its balance sheet just did not exist in the case of a government.[7]

The position that was finally developed and accepted in practice was a compromise of accounting for fixed assets without recording depreciation. The author of this position, it appears, was Lloyd Morey. He wrote as follows:

> It is noted that accounts with property are charged with the cost of all property acquired, and that, when and if any property is disposed of, the accounts are credited with the cost of that property. Ordinarily, there is no occasion for taking account of depreciation of permanent property, for the following reasons:
>
> (1) There is no particular occasion for knowing the current value of government property, since the government does not depend for credit or for any other purpose on the valuation of the property owned by it.

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[7]Francis Oakey, Principles of Government Accounting and Reporting (New York: D. Appleton and Company, 1921), p. 234.

(2) The chief item of interest in accounts with permanent property is "What did that property cost the government?"

(3) Since no accounts are kept with profit and loss, there is no occasion for accounting for depreciation as an expense.

(4) A reserve for depreciation would be useful only if it could be funded and carried forward to provide for replacement of the property when worn out. This is impossible; first, because governmental revenues for the most part are fiscal in character and must be expended during the fiscal period; and, second, because the greater part of public property is acquired through bond issue and it would be impossible to raise by taxation an amount to provide for depreciation in addition to paying the principal of the bonds.

The above reasons do not apply to any governmental operation in which profit and loss are involved, such as a public utility or other similar enterprise. In such cases depreciation should be entered as an expense, as in a private enterprise and a Reserve for Depreciation account credited.

If depreciation is entered for general property Surplus Invested in Fixed Assets is simply debited and Reserve for Depreciation credited.[8]

Morey's arguments were fashioned primarily around the non-profit dichotomy. When, as in the case of a utility, an organization is in a profit or cost recovery situation, he recommended the recognization of depreciation. Morey remained firm in his position on fixed assets accounting through the years though his position was subject to considerable criticism.[9] However logical or illogical his arguments, his concept of fixed asset accounting had an important and lasting influence.

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[8]Morey, p. 196.

[9]David Green, "Depreciation of General Fixed Assets in Governmental Accounts," Municipal Finance, XXXIV (May, 1962), p. 162.

The 1936 National Committee on Municipal Accounting Statement practically paralleled Morey's:

> There seems to be little occasion for recognizing in the general account records the depreciation of general municipal buildings and equipment. The reasons are:
>
> 1. It is not necessary to know the depreciated or replacement values of municipal properties, since property values cannot be used as a basis for credit.
> 2. Since the municipality as a whole is concerned with operating profit or loss only in the case of utilities and other self-supporting activities, it is not necessary to account for depreciation in the general accounts.
> 3. If depreciation is accounted for, the depreciation reserve has no importance unless a cash fund of an equal amount is set aside to replace worn-out properties. This is usually impractical, where not illegal.
>
> The primary purpose of fixed-asset records is to show the municipality's investment in such assets. This amount has no particular relation to the amount of the bonded debt, much of which may have been incurred for purposes other than the acquisition of fixed assets. On the other hand, a large part of the fixed assets may have been acquired in ways other than through bond issues. Rarely is any part of the bonded debt secured by mortgages against specific properties, except in the case of utilities. Fixed assets usually cannot be seized or sold to satisfy bonded indebtedness.[10]

Subsequent restatements by the National Committee have continued the "no depreciation" statement. "Depreciation on general municipal fixed assets should not be computed unless cash for replacements can legally be set aside."[11] "Depreciation

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[10] National Committee on Municipal Accounting, Municipal Accounting, p. 119.

[11] National Committee on Governmental Accounting, Municipal Accounting, p. 2.

of general fixed assets should not be recorded as an expense in governmental accounting because no constructive purpose would be achieved by doing so."[12]

The 1968 Revision makes the following provision for accounting for fixed assets.[13]

(1) Tangible long life assets of significant value are to be recorded at original cost, estimated cost or appraised value as required by circumstances.

(2) In funds where job costs are necessary for determining use, charges to other departments such as intergovernmental funds depreciation can be recorded in accounts as long as they are kept separate from general proprietary and budgetary accounts.

(3) In Enterprise funds depreciation can be recorded in a manner similar to the practices of a commercial operation.

(4) The general fixed assets of an enterprise are accounted for in a separate self-balancing set of accounts (General Fixed Assets Group of Accounts).

General fixed expenditures for fixed assets are recorded by two entries, as shown in the following example:

(a) on books of general fund:
Expenditure
Cash

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[12]National Committee on Governmental Accounting, Governmental Accounting, p. 11.

[13]Ibid., pp. 10-11.

(b) on books of general fixed asset group:
Buildings
Investment in General
Fixed Assets--General
Fund Revenues

Similar dual entries are made from other funds. Not all fixed assets are recorded in this account group. The Enterprise, Working Capital and Trust funds maintain their own asset accounts.

A detailed research and examination is made of the arguments both pro and con for the recording of depreciation in the Report of the Committee on Accounting Practice of Not-for-Profit Organizations. A summary of these arguments is shown in Table 7. Additional research in this area would appear redundant.

A wide variety of actual practices are followed in accounting for fixed assets and their depreciation in local governments. With the exception of hospitals and some local government utilities, few organizations account for depreciation. Through the 1950s, depreciation accounting for hospital fixed assets generally had not been adopted.[14] In recent years, because of the necessity of recording depreciation as a basis for cost reimbursement from insurance companies and the medicare program, hospital depreciation accounting, though widely debated, is generally practiced in some form.

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[14]See T. Leroy Martin, Hospital Accounting Principles and Practice (Chicago: Physicians' Record Company, 1951), p. 63.

TABLE 7

ARGUMENTS FOR AND AGAINST DEPRECIATION OF FIXED ASSETS IN NON PROFIT ORGANIZATIONS[a]

Against Recognition	For Recognition
Serves no useful purpose. Depreciation accounting is necessary only to measure profit--NFP organizations are not organized for profit and profit or loss determination is irrelevant.	Accrual accounting is essential in an understanding of the financial status (and change in status) of all organizations--should be cognizant of a total NFP resource availability, utilization, and capital implementation or diminution.
Taxes, not fixed assets, provide revenue--recognition would violate the matching concept.	Expenses need not physically "Produce" revenue directly. In reality we match revenues and expenses to periods, often separately.
NFP organizations exist on a year-to-year basis--are not going-concerns.	Where power of self-perpetuation exists via taxes, NFP entities are extremely "going"--it is more necessary to give full accounting than in private enterprise because of this power and their broad social impact and responsibility.
Recognition would result in double-charging current generation.	Cost determination separate from "price determination." Are now unaware of costs or who bears them--may be triple charging or half charging. Cost determination and "price-setting" are separate problems--accrual cost data are often useful in setting pricing policies.
Recognition might result in a deficit--this would upset the public.	We should report clearly and truthfully--many organizations acquire excess resources in some periods and deplete these subsequently. Such should be reported.
Recognition would be confusing--fund and budgetary considerations dominate NFP accounting. Expenditures are budgeted and must be accounted for--depreciation expense is not budgeted.	Funds and budgets are control devices and adherence must be reported. A single report will suffice only where budget is expense-based. Otherwise, we must separate current fund budgetary accounting from financial accounting as is done in profit-oriented organizations. Alternatively, we can adjust budgetary statements for capital outlay and depreciation.

Recognition is technically unmanageable in fund accounting structure--a good place for a debit but no place for the credit as fixed assets are not in fund accounts.	Several expedient alternatives are available--for example, hospitals account for depreciation through expense-equity adjustment of fund structure and/or account classification.
Recognition of depreciation would be misleading as:	Failure to recognize depreciation is more misleading. The contra arguments are irrelevant because:
a. "Reserve" for depreciation implies cash availability.	a. This argument was settled years ago--it is a nomenclature problem.
b. "Value" of fixed assets is academic question--"Cost" is all that is of importance.	b. There is no attempt to measure "value" but rather costs consumed and the cost of service potentials remaining within the organization.
c. Asset was donated--NFP has no depreciation expense.	c. The donation was a contribution of capital--the source of capital does not determine the measurement of its consumption.
d. We may not replace fixed assets or will replace through public subscription or individual donation.	d. See above--also, expense measurement and asset replacement are separate problems.
Fixed assets are a heritage of past administrations--is unfair to charge current administration with past mistakes.	Currently not accountable for use of them at all--should use or dispose of, clearly indicating reasons and effects.
Fixed assets do not depreciate if properly maintained.	Depreciation and maintenance are largely separate problems. Even so, who is to determine adequacy or propriety of current maintenance? Maintenance expenditures frequently are deferable to the next administration, or at least until after the next election.

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[a]American Accounting Association, Committee on Accounting Practices of Not-for-Profit Organizations, "Non Profit Accounting, p. 117.

Accounting requirements of the federal government, as we saw in fields of education, welfare and public health, generally did not require and made no provision for depreciation accounting. Few local governments follow carefully the relatively complicated procedures set out by the National Committee for fixed asset accounting. The larger the unit, the better the chance that National Committee procedures will be followed. In all but the largest cities, the general procedure followed is to prepare an entry debiting the fixed asset and crediting the liability or cash accounts when purchase is made. No system involving a separate General Fixed Asset Group of accounts is used and generally no depreciation is taken on any assets whether they are of an enterprise of general fund classification.

Generally this writer's investigation has shown a general laxity in the total fixed asset accounting subsystem. Often a city or a county has no effective record of property or equipment upon which to base accountability or make decisions on replacement, maintenance, security, or insurance. Many units would require an extensive, costly inventory and legal search even to determine the land owned.

Basis of Accounting

The basis of accounting refers to the timing of when financial transactions are recorded and reported. Under the cash basis financial transactions are recorded in accounts only at the time cash is received or paid. Under the accrual basis, financial transactions are recorded as they actually take place (that is, as

goods and services are purchased or revenues earned) even though the flow of cash occurs at different dates.

The accrual basis of accounting has long been regarded as a corner stone of good accounting practice in the private sector. This is not true in the local government area where a variety of practices are recommended and followed.

Although under the simplistic financial procedure advocated by the turn of the century municipal reform groups no basis of accounting was specified, the sample reports were presented on a cash basis. An integral feature of this procedure was the reconciliation of the cash position by adding to the beginning cash balance the receipts and subtracting the expenditures to obtain the ending cash balance.

Various positions were taken during the next decades by various authors and organizations. At first, during the 1920s, there appeared to be a general movement toward the full accrual method. The "Standards of City Finances" recommended by the Detroit Bureau of Governmental Research stated that

> Municipal accounting should be maintained on an accrual basis. . . . The greatest forward step that has been made in municipal accounting has been the establishment of such control over revenues accrued but not yet collected and liabilities incurred but not yet paid that a complete statement . . . can be presented.[15]

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[15]Upson and Righton, "Standards," p. 130.

This accrual basis was also recommended by both Oakey in his writings and the Bureau of Municipal Research of New York.

The publication of the National Committee on Governmental Accounting initially took no stand. The 1934 monograph stated:

> If revenue is accounted for on an accrual basis . . . the report should be prepared on that basis. . . . If revenue is accounted for on a cash basis . . . the reports should be prepared on that basis.[16]

This stand was similar to that taken by Morey in his 1927 text.[17]

The revision in their Bulletin No. 5 took a slightly stronger approach, "The use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical . . ."[18] This recommendation remained basically unchanged until the 1968 Revision.

In the 1968 Revision, the National Committee on Governmental Accounting prescribed what it terms a full accrual basis for the Enterprise, Trust, Capital Projects, Special Assessment, and Intragovernmental Service funds and a "modified accrual" basis for the General, Special Revenue, and Debt

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[16]National Committee on Municipal Accounting. A Tentative Outline--Principles of Municipal Accounting (Chicago: Municipal Finance Officers Association, 1935), p. 7.

[17]Morey, Manual, p. 159.

[18]National Committee on Municipal Accounting, Bulletin No. 5 (Chicago: Municipal Finance Officers Association, 1935), p. 3.

Service Funds. The term accrual however as used by the National Committee and as used in the private sector differs considerably. Revenue, for example, in a particular fund might include loan proceeds or sale of an asset carried in another fund. As used by the National Committee the term "accrual" also refers to the timing of expenditures, not to expenses or costs consumed or expired. Under its definition some payments for debt retirement, certain capital outlays and purchases of materials and supplies even though not consumed in the period would be included as expenditures. Such treatment is distinctly at variance with the accrual concept of the private sector's accounting system.

The National Committee defines "modified accrual" basis as follows:

> The modified accrual basis of accounting is defined as that method of accounting in which expenditures other than accrued interest on general long-term debt as recorded at the time liabilities are incurred and revenues are recorded when received in cash, except for material or available revenues which should be accrued to reflect properly the taxes levied and the revenues earned.[19]

As far as revenue goes, the system is for practical purposes identical to the "full-accrual" basis; while expenditures have but the one exception.

Support for other than a full accrual basis has resulted from a number of factors. To some considerable extent, public

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[19]National Committee on Governmental Accounting, Governmental Accounting, p. 11.

officials have not understood the concept and have viewed the accrual basis as some accountant's "trick" to keep them from knowing how many dollars were spent and how many were received. The National Committee's arguments are rather garbled when discussing this point. It points out that the basis of accounting is important in arriving at the financial position of the fund and notes the cash basis can result in manipulation. On the other hand it states that for certain funds the full accrual is not feasible or practicable and gives as a reason that these funds do not match revenue and expense for the purpose of determining profit. The cash basis is of course much easier to operate, recording transactions only when cash changes hands.

Both Henke and the Committee on Accounting Practices of Not-For-Profit Organizations recommended use of the full accrual basis.

Fund Accounting

The National Committee on Governmental Accounting has defined a fund as:

> An independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.[20]

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[20]National Committee on Governmental Accounting, Governmental Accounting, p. 6.

Local governments establish funds for a number of reasons. They are set up because of legal requirements either state statutes or local charter or ordinance; others are based on the decisions of administrators or local legislative bodies, some are maintained through custom, or because it is considered good managerial or accounting practice. Fund accounting results in segregating the resources, and the equities of an organization into separate accounting entities. Each fund that is established must be accounted for so that the identity of its resources, equities, receipts and disbursements are continually maintained. Separate financial statements are also prepared for each fund.

The fund accounting concept has a rather nebulous chain of development for it gradually evolved in various places over the years. Historical records show that at a very early date those involved in government found that to stop diversion of resources from designated purposes the most workable approach was to set the resources aside in such a way that they could only be used for that purpose.[21] In government where a unit collects taxes for specific as well as general uses, where it may receive funds as trustee, and where expenditures are controlled by the legislature through which the appropriation is processed, the chance was high that resources could end up being used for other than designated purposes. To prevent unauthorized

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[21]Financial records of the City of Buffalo, for example, show that as early as 1855 a separate "Local Fund" was maintained for assessments for improvements.

diversions, cash was segregated into a separate cash fund ledger account, each with its own bank account. At first under the simple single entry cash basis accounting, the fund was merely an account in which money was deposited to be spent for a definite purpose. This concept of a fund was well established by the turn of the century.

> a careful consideration must be given to a practice which is quite common, and which leads in many instances to deceptive results. The use of a fund system. . . . Objectionable as it is in some of its features, the system has become thoroughly rooted in the financial methods of American cities.[22]

Originally as the fund concept was practiced there was no separate consideration of equities. Then double entry accounting was generally adopted after the turn of the century. This system made it necessary for all assets, not just cash, and the equities in those assets as well, to be measured. The old cash fund concept lost favor because of its inability to limit resource application effectively.

> The modern fund concept, therefore, developed naturally out of the old fund concept because advances in accounting technique made it possible to exercise control more adequately by means of the modern fund concept.[23]

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[22]Samuel Sparling, "The Importance of Uniformity," p. 14.

[23]Robert James, "Three Major Concepts in Governmental Accounting Theory," Municipal Finance, XXV (July, 1950), p. 309.

In the transitional period, the Handbook of Municipal Accounting did advance a concept in which only the budgetary accounts were maintained on a fund basis.[24] This concept never gained wide adoption, however. Budgetary and actual accounts were shortly combined in the same account groupings and with a few minor changes this is the modern fund concept.[25]

The National Committee on Governmental Accounting in their research and publications on governmental accounting has attempted to remedy several flaws in the existing fund process.[26] There was and still is a great tendency for units to have far too many funds. This so subdivides the accounting for the entity that any attempt at meaningful analysis becomes impossible. The National Committee has recommended that the number of funds be kept to the minimum required by law and good practice and has set out a model inclusive classification scheme of eight funds. There was difficulty and no common pattern in accounting for interfund transactions. The National Committee provided model entries and techniques for accomplishing interfund transactions in a uniform manner. Finally there was some considerable confusion in accounting for fixed assets and long term debt and interest. With the peculiar methodology that had

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[24]Bureau of Municipal Research, Municipal Accounting, pp. 14-20.

[25]One of the earliest examples of this can be found in Oakey, Principles of Accounting, p. 16.

[26]Frank Galisderfer, "Fund Accounting and Financial Reporting," Municipal Finance, XXXI (November, 1958), p. 82.

evolved in accounting for fixed assets and their financing, many were at a loss of how and where to record these accounts. In order to meet this problem, the National Committee recommended two separate self balancing groups of accounts. The account groups, one for fixed assets and one for long term debt, provided a common methodology for recording these items. Overall the fund methodology as promulgated by the National Committee appears to have changed little through the decades.

The fund concept has come under much criticism because of the way in which it subdivides the accounting and reporting for a single entity.

> The accountant preparing financial reports for organizations using fund accounting techniques always faces a dilemma. Statements must be prepared to reflect the financial activities for each fund as an entity. On the other hand, the external groups are interested in an evaluation of the entire organization as an operating unit.[27]

> . . . the entity is considered to be the total operating unit, but under fund accounting the focal object of accountability . . . a set of individual fund subentities . . . financial reports become mere summaries of transactions within subsets and not expressions of the activities, achievements, and position of the overall operational entity.[28]

Because of the depth to which fund accounting is ingrained in the local government accounting process, recommendations for

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[27]Henke, Accounting, p. 69.

[28]American Accounting Association, Committee on Accounting Practice of Not-for-Profit Organizations, "Not For Profit," p. 99.

improvement or change have not contemplated abolition of the fund structure. Fund accounting must be regarded as a system given, at least in the foreseeable future. Recommendations for change and improvement have been aimed at development of additional supplementary statements which would cross fund lines and provide information for the reporting entity as a whole. This type of recommendation was made by both Henke and the Committee on Accounting Practice of Not-For-Profit Organizations.

Cost Accounting

Cost accounting, or the art of determining the cost of a product, a service, or an activity, has in recent decades played an important role in the administration of profit oriented institutions. Cost accounting, including budgeting, cost analysis, comparison with standards, planned, historical and actual costs, has contributed greatly to the implementation of the process of modern management. To a considerable degree, it has made possible effective quantitative decision making and the national selection of objectives, the delegation of authority and responsibility and the subsequent measurement of accountability and highlighting of primary items requiring management action.

The use of cost accounting in local governments has remained relatively rare. Although organizations such as the National Committee on Governmental Accounting and the American Hospital Association have long advocated that cost systems be

established, little progress, except in isolated instances, has been made. Cost classifications are ordinarily based on objects of expenditure. Classification such as indirect-direct, fixed-variable-semivariable, or controllable-non-controllable, which are pertinent to cost analysis are almost completely lacking. The use of standard costs is extremely rare. In making budgetary decisions estimated costs of projects are often used but no feedback system exists to report actual costs incurred.

This dearth of cost accounting systems stems from a number of factors. Part of the lack of attention stems from the not-for-profit syndrome with statements such as: There is no need to determine service costs because revenues and expenditures are not related. The services have to be furnished society regardless of cost. We aren't producing goods for sale, but a service to society that can't be measured. The methodology that evolved for accounting for fixed assets with separation of the accounts, and not computing depreciation, has made it difficult to include complete costs into the system. The same case can be made against the cash or modified accrual basis of accounting which works against the flow of data necessary for an effective cost system. Many administrators or legislators, especially in smaller units, maintain that with the resources and personnel available, the costs of such a system far exceed the benefits derived. Performance measurement has traditionally been geared to determining if funds expended stayed within the limit of funds appropriated. Although there was a compulsion

to develop budgetary accounts and integrate them into the system, no similar force has worked for development of cost systems.

There has not been a complete lack of development of cost systems in the public sector. Under the provisions of Medicaire (Public Law 89-97) all hospitals are now required to establish cost accounting methods to receive cost reimbursements. The progress here except in some of the larger hospitals has been geared strictly to cost determination for fee purposes.

> Unfortunately most hospitals neither understood what was required nor had qualified personnel or adequate cost systems to meet the requirement.[29]

Public schools have also evolved a financial system which results in rough cost data of some types. The comparative cost data are gathered and published in Georgia by the State Department of Education. This cost system provides limited comparative data on a statewide basis but does not provide data for local decision making.

Researchers have stressed that although current reporting practices were designed to answer questions concerning safety of funds used and how they were used, they do not answer the question of how efficiently they were used. Recommendations for improvement run from development of an integrated cost system that will:

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[29]American Accounting Association, Committee on Accounting Practices of Not-for-Profit Organizations, "Not For Profit," p. 130.

> produce accrual-based data that will allow the determination of (1) total organizational expenses, (2) costs of functions or activities, and (3) unit costs of measurable output.[30]

to proposals such as:

> A third statement showing unit costs on the basis of standard and accepted quantitative factors should be prepared and become a standard part of the presentation.[31]

Uses of Financial Reports

Originally, public financial reports were aimed at keeping governmental officials honest. This remains a primary purpose even today. For this purpose, the financial report is coupled with the financial audit to serve as a means of review and public pronouncement on stewardship of public resources.

> . . . public opinion under any regime is bound to favor the principle that public resources should be handled with scrupulous honesty and that procedures should exist to guarantee this.[32]

In Georgia, as we have seen, in all but a few cities and counties, the auditor actually prepares the financial statement as a part of his engagement. For the most part, local government financial audits have consisted of determining that each

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[30] Ibid., p. 134.

[31] W. Lynn Fluckiger, A Philosophy of Fund Accounting, Journal of Accountancy, CXV (August, 1963), p. 71.

[32] B. L. Normanton, The Accountability and Audit of Governments (New York: Frederick A. Praeger, 1966), p. 80.

item of income and expense has been properly posted, duly entered into the correct account at the proper time, that the accounts themselves were correctly totaled and balanced, and that each payment was properly authorized.

Examinations made of local government financial audit reports cast grave doubt on the effectiveness of many local government audits. For example in the Georgia study, 33 percent of the audit reports made no reference to the examination being made in accordance with generally accepted auditing standards and only 46 percent of the audit reports stated all audit procedures considered necessary in the circumstances had been performed. The study done in Illinois showed that 22 percent of the audit reports reviewed in that analysis did not represent the examinations had been made in accordance with generally accepted auditing standards and that only 60 percent of the reports stated all audit procedures considered necessary had been performed. In the Georgia study, only 29 percent of the audit reports expressed an unqualified opinion on the financial statements. In the Illinois study, 50 percent of the audit reports expressed an unqualified opinion on the financial statement.

Concerned knowledgeables, reviewing local government audit reports, generally arrive at what appears to be the consensus view of the inadequacy of the audit and of the report made for purposes of determining financial stewardship.

This inadequacy results from a number of reasons. The American Institute of Certified Public Accountant's Auditing

Standards state that the auditor must have adequate technical training and proficiency and that he must exercise due professional care in the engagement. Based on the examinations made, it appears doubtful if the auditors have adequately prepared for the engagement. As one member of the Illinois Society making that study noted:

> It might be presumed that every certified accountant, and particularly every member of the Illinois Society, has the requisite technical training and proficiency for any audit job he undertakes. Our study showed that this isn't necessarily so. There were two principle deficiencies disclosed by our review. The first was a failure to keep up with changing trends; and the second was a failure to prepare properly for a specialized job.[33]

This same questioning has been openly expressed by others. John L. Carey sounded a warning that strikes at the heart of the competence problem:

> The profession must provide assurance that CPAs engaged to make audits in accordance with regulations of government agencies will do a good job. They must strictly comply with generally accepted auditing standards where appropriate and with the special rules and requirements . . . too many instances of substandard work on the part of independent CPAs may result in a reversal of the present trend to enlist their aid.[34]

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[33]Herbert Istrow, "Review of Illinois Municipal Audit Reporting," The Illinois CPA, XXX (Spring, 1968), p. 32.

[34]John L. Carey, The CPA Plans for the Future (New York: American Institute of Certified Public Accountants, 1965), pp. 161-162.

Most students graduating from college are given but a brief exposure to governmental accounting, if that. Although a few of the larger firms provide advance training in public sector audits, most firms either have no formal training program or have not felt this subject was of sufficient importance to include in their training program.

There is now a general lack of authoritative guidelines for public sector audits. The National Committee on Governmental Accounting's recent publication, Governmental Accounting, Auditing and Financial Reporting, provides some simple guides to local government audits but as Knighton notes:

> These guidelines reflect a rather traditional approach to the audit function and consequently give little help to auditors whose responsibility extends beyond traditional areas. Moreover, this list of procedures is not given as the product of any significant research effort nor is it designed to be a professional statement of standards or principles.[35]

Beyond the National Committee's publication and a few state bulletins, there are no authoritative standards or guidelines for public sector audits.

Another problem facet is the public sector environment itself. The public officials with whom the auditor must contract are frequently more worried about the cost of the audit than anything else. Many audits are restricted in scope by

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[35]Lennis M. Knighton, "Public Sector Audits by CPA Firms," Texas CPA, XLI (October, 1969), p. 26.

contracting officials who refuse to pay for such audit functions as confirming receivables or verification of inventories or physical assets. The general lack of satisfactory financial records, the inadequacy of internal control and the low level of training of local government accounting personnel also make an effective audit that much more difficult.

Finally there appears to the writer after talking with a considerable number of public officials, a considerable misconception of what the audit does and what its purpose is. Although at one time the audit was primarily fraud-preventive, auditing has gradually expanded in scope. As auditing has developed, there has been a gradual change away from detailed verification to testing. The objective of the audit has become more and more directed towards ascertaining the fairness of the financial statements of the organization and appraising its internal control system. Most local government officials appear to view the auditor as the expert, who, when he has completed his audit and made his report, has verified that no fraud exists and that the accounting system is adequate. In this respect, it is interesting to note the Kansas court case of the Board of County Commissioners of the County of Allen versus Baker and Miller Licensed Municipal Public Accountants. The Kansas Supreme Court, in handing down its opinion, stated:

> The purpose of a county audit is not merely to comply with the statute . . .--its primary purpose is to determine whether the accounts and records of the county are being accurately and honestly kept. When the county commissioners . . . employ

> accountants to make the audit, they contract for skill accuracy and fidelity on the part of those who represent themselves as experts in this line of work. If services which measure up to that high standard are not furnished, the breach of the contract is fundamental.[36]

Particularly in smaller units, local government administrative and legislative bodies, often one and the same, use financial reports for determining future resource allocations. This is what would normally be called management decision making. Although the financial reports are not particularly designed for that purpose often they are all that are available. Decisions as to capital purchases, changes in salary, new positions, and tax rates are often heavily influenced by the financial report. Prevailing practices vary widely between individuals and locations. Units administered by professional managers more often than not develop some sort of management information system which gear data collection and summarization in a more timely manner to specific decision areas. Some councilmen or county commissioners have a sort of figure phobia and wouldn't look through the financial report if their life depended on it. Others appear to have studied the report at some length and are considerably influenced by its data.

Local government financial reports serve as a basis for much of the research data used for studies performed on public finance and administration by educational, research and

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[36] W. G. Hamilton, "Relationship of the Independent Auditor to the Municipality," Municipal Finance, XXIIV (August, 1955), p. 23.

government organizations. One of the purposes of the reform movement at the turn of the century was to gather uniform financial data that would enable inter-unit comparison. Presumably this comparative data could be used by citizen and researcher alike in determining the effectiveness of resource allocations and relative efficiency of public officials in resource management. Problems attendant in obtaining uniform accounting data have long been recognized, as witness this writer's comments in 1908:

> . . . dangerous for the advocate of uniform schedules to hitch his chariot to them alone . . . they cannot be considered a universal panacea for municipal accounting ills, nor a safe and adequate basis of comparison of results obtained by different cities.[37]

The only significant attempt today at collecting and publishing comparative local government financial information is that of the U. S. Census Bureau. (A continuation of their efforts starts at the turn of the century.) Perhaps the best known and most useful publication of the Bureau along this line is the Census of Governments. This publication presents, every five years (1957, 1962, 1967), relatively detailed financial data, if available, on virtually all local government units. The financial statistics are based primarily on a mail canvass. For sizeable local government units the Bureau compiles the basic information from official local reports. Although the

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[37]Morgan L. Colley, "Standardization of State and Municipal Accounting," Journal of Accountancy, V (February, 1908), p. 274.

Bureau now has decades of experience in this area, the data reported is useful in comparative analyses only in a very restricted sense. As the Bureau itself warns:

> Efforts to utilize the reported data for intensive interstate or intergovernmental comparisons may need to take account of the diversity in placement of responsibility for various functions as among particular types of governments. . . . Even within individual States, one may observe marked diversity in the scope of functions performed by individual units of a particular type.[38]

The writer has worked closely with both Census data and published financial reports for several years. He is of the opinion that the only way to obtain comparative data, except for the roughest of measures, is to actually examine in detail the reports of the units you wish to compare. The system of local government record keeping and reporting now in existence does not lend itself to inter-unit comparison. This is not to say that more refined data would not be useful, or that some researchers do not use the data now available. Anyone who plans to use Census of Government data for analysis, prior to using the data, should compare the census forms and the financial reports for several of the units in his study. This should enable him to grasp to some extent the problem of inter-unit comparability and set limits on the conclusions he can draw from the data.

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[38]U. S. Bureau of the Census, Census of Governments, 1967, Vol. 4, No. 5: Compendium of Government Finances, (Washington, D. C., U. S. Government Printing Office, 1969), p. 15.

Financial reports of local government are used as a part of the local government reporting system directed toward its citizens. Although other facets are included in the communication stream between the government and its citizens, financial data most often have a high priority. Sometimes the reports themselves are presented directly to the public through mailing, publishing in the newspaper, or posting on the courthouse or townhall door. In other cases the information is abstracted and presented in charts, graphs or summaries.

The extent of interest of the general public in financial reports and the most effective manner of presentation of local government financial data remain a matter of debate. The latest publication of the National Committee on Governmental Accounting states:

> The general public, composed of individual citizens, taxpayers, and political groups, is vitally concerned with the cost of public services, the adequacy of revenues in meeting such costs, and the stewardship and efficiency of both elected and appointed public officials in administering the government's financial transactions.[39]

There is some doubt as to how vitally the public is concerned with local government financial data. Some believe that the public becomes interested only when a controversy arises or a crisis occurs.

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[39]National Committee on Governmental Accounting, Governmental Accounting, p. 1.

The degree of public interest in local government financial data, the classes of data presented, and the manner in which this is attempted are interrelated problems in the local government communication system. Local government financial reports have long been noted for not being geared to citizenry. "The usual report contains much that is of little or no import and omits nearly everything of use to a voter in forming judgments."[40]

The disinterest of the public in local government affairs has been widely discussed:

> . . . he did not know -- he did not know that it was worthwhile to know -- how the city hall was run.[41]

> In wanting to reach the public, the foremost fact to remember is that the public does not want to be reached . . . public busy . . . jealous of its time . . . resentful of intrusions.[42]

Local government financial reports as they are now prepared, in most instances, the writer has found, tend to discourage public utilization. This is not to say there is not considerable interest in local government financial data or that pertinent information cannot be transmitted effectively only that it in most cases is not.

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[40]Wylie Kilpatrick, Reporting Municipal Government (New York: Municipal Administration Service Publications, 1928), p. 7.

[41]Sinclair Lewis, Babbit (New York: Harcourt Brace and Company, 1922), p. 19.

[42]Horace Busby, "Propaganda? Or Public Information?" Public Management, XXXV (March, 1963), p. 38.

Since the 1930s, as intergovernmental relationships have grown, so have the requirements for local financial reporting to their state and the federal governments. The 1930s gave birth to a large number of Federal programs in the areas of welfare, employment security, housing and health. The following years brought forth many new and expanded programs. Federal aid to local governments has about tripled within the last decade. These programs are administered through 150 major Washington bureaus. Unfortunately, in the past, Federal agencies have not coordinated needs for financial data.

> The multiplicity of program requirements by differing Federal agencies may frequently lead to conflicts in accounting requirements; and there is much that has to be done in accounting for federally sponsored programs.[43]

Both Weitzel and Kelley, the Comptroller Department of Health, Education, and Welfare, agreed that what is needed is to develop acceptable accounting principles and standards which would provide a valid framework in achieving as much consistency as possible.

> . . . it would be worthwhile to develop acceptable principles, alternative approaches to various aspects of the problem and some model systems.[44]

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[43]Frank H. Weitzel, State and Local Accounting Programs (Chicago: Municipal Finance Officers Association of the United States and Canada, Bulletin 1968B, 1968), p. 4.

[44]James Kelly, "Improving Financial Management for Recipients of Federal Funds," Journal of Accountancy, CXXI (January, 1969), p. 33.

It has been recognized for some time that the interests of the Federal and state governments go beyond traditional reports no matter how uniform they may be.

> . . . it is not enough to report and comment on historical transactions. It is not enough to make recommendations that affect only the past. . . . reports will have to go far beyond that if they are to play a role in fostering better management.[45]

The Federal government would like to obtain what is thought of as "management" type information in the reports they receive.

> . . . essential that we take whatever steps are necessary to improve our financial management and reporting in order that appropriate information will be available to help support analyses of program costs and benefits.[46]

This trend coincides and is spurred on by the increasing emphasis on PPB systems and a management tool at the Federal level.

There have been recommendations for many years that conventional financial reporting be expanded to report on efficiency as represented by standard units of output and corresponding costs.

Fluckiger, as noted, recommended that a new statement be prepared to report on efficiency of resource utilization.

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[45] Ibid.

[46] Weitzel, Accounting Programs, p. 6.

> Financial reports for nonprofit institutions which are prepared according to current practices . . . do not answer the question as to efficiency . . . A third statement showing unit costs on the basis of standard and accepted quantative factors should be prepared and become a standard part of the financial presentation.[47]

Many on the other hand are critical of this type of approach, believing it can only lead to misinterpretation and misuse of information provided.

Local government financial statements are used by creditors, investors, and bond rating services for analyzing the unit's credit for future debt and for appraising existing debt. Local governments borrow money for many different reasons and by different techniques. Not only is money borrowed for capital improvements, both warrants and notes payable are used for tax anticipation loans, bond anticipation, loan and disaster or emergency purposes.

So many new municipal debt issues come to the market that investors have come to rely heavily on bond rating systems and the analysis of specialists in the municipal field. Usually only the largest bond issues receive a formal rating. Moody's Investors Services provides ratings without cost on all municipalities with gross debts of $600,000 or over. Standard and Poor's Corporation, the other national rating firm, rates only

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[47] W. Lynn Fluckiger, "A Philosophy of Fund Accounting," Journal of Accountancy, CXV (August, 1963), p. 7.

upon request and charges a fee.[48] The rating does not dictate the interest rate to be obtained when the bonds come to the market, but it does have an important bearing on the final bid set by the underwriter. The rating is also used by government regulatory agencies as an official guide to determine what kinds of bonds financial institutions will be allowed to add to their portfolios.

In determining credit standing in addition to the data provided by financial reports, the analysts also consider such factors as the economic background of the units (growth, occupational groupings, transportation facilities, diversification), the legal restrictions on bond issuance, the political history of the community, and the willingness of the community to pay its debt.[49] It has been estimated, however, that only 10 percent of municipal bond issues are formally rated.

What data do bond analysts, investors and banking institutions seek to draw from financial reports. This of course varies by type and amount of debt. For relatively small short term debt, as for example in the case of tax anticipation loans, local banks rely on previous local credit history. Many local governments borrow short term funds yearly because of their fund flow. When the amount of the debt is large and/or the

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[48]John C. Clark, "Local Government Bond Ratings," Popular Government, XI (March, 1968), pp. 20-23.

[49]George A. Hempel, Measures of Municipal Bond Quality, (Ann Arbor, Michigan: University of Michigan Bureau of Business Research, 1967), pp. 16-42.

lending institution or investor is more sophisticated in addition to credit history other financial factors will be considered. The debt structure is reviewed. The unit's debt is related to assessed valuation, the proportional debt of overlapping units is calculated, and the rate of debt retirement, and debt trend determined. The current operating record is reviewed, including tax collections, whether the unit is operating at a surplus or deficit, and whether an effective budget is in operation. The unit's cash flow is sometimes analyzed. This usually involves computing the annual year end cash position showing to what extent free cash in the hands of the city, and available for miscellaneous purposes, exceeds, or fails to equal, the outstanding current liabilities.

In summary it seems fair to say that the financial reports of local governments serve a wide variety of users for many purposes. Further that the manner in which the report is used by a class of users for a type of use varies considerably based upon such factors as the type of organization, the magnitude or resources involved and the sophistication of the user. The problem of identifying relevant use patterns has long been recognized by researchers.

> The identification of many of the various users of accounting information and some of the decisions and judgments they make permits some generalizations regarding the uses to which this information may be put. These uses are necessarily stated only in general terms, because, as pointed out above, the

> decisions of users cannot be described in terms of fully known detailed decision models.[50]

The predominant use of financial statements of local government historically has been to report on the legal stewardship of public funds.

> Current accounting and reporting practices of most NFP organizations, . . . almost exclusively evolved from and focused upon legalistic dollar accountability for individual fund entities on a year-by-year basis.[51]

It is not that financial reports are not used for other purposes, but rather that this has been dominant. If the financial reporting principles and other recommendations of the National Committee on Governmental Accounting were followed, and if a periodic audit was conducted of the unit's financial records in accordance with the auditing standards of the American Institute of Certified Public Accountants, the financial statements could adequately provide legal dollar accountability. The analysis of actual practices as recounted in Chapter IV made clear that recommended practices are not always carefully followed. This facet of the problem area can be solved by mutual cooperation of state regulatory officials and state societies of certified public accountants. The real crux of the problem area is that in today's environment there are other

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[50]American Accounting Association, Basic Theory, p. 23.

[51]American Accounting Association Committee on Accounting of Not-for-Profit Organizations, "Not-for-Profit," p. 82.

important needs to be met by financial reports which even if the National Committee on Governmental Accounting current recommendations were followed would not be satisfied.

> The presently recommended municipal accounting system was designed . . . and does enable administrators to demonstrate . . . that legal constraints have been adhered to . . . these groups now and in the future are faced with information needs beyond the capabilities of the present system . . . the presently recommended municipal information system must be modified to provide information for rational resource allocation. . . . The presently recommended accounting information system offers little help in the measurement of benefits of municipal programs either ex post, or ex ante. Improvement in both areas is urgently needed.[52]

The consensus viewpoint of concerned knowledgeables is that the financial reports must also be refashioned to play an important role in local government resource allocation (planning) and in determination of the effectiveness and efficiency with which resources have been spent (control). This study will present in the concluding chapter a set of financial accounting principles that if followed would result in financial reports that would meet organizational needs for planning and control information in today's environment.

Case Study of Financial Reporting

In this last section of the chapter, an actual case study of the financial reporting of a local government is reviewed.

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[52]Leon Hay, Municipal Accounting in the 1970's (Chicago: Municipal Finance Officers Association Special Bulletin 1971B, 1971), pp. 9-10.

The case study presents a good summary for this chapter for it involves as a part of the problem situation local government organization characteristics, unique characteristics of local government accounting, and perhaps most important, points out the inadequacies of financial reporting under the present system.

DeKalb County is a segment of the urban Atlanta complex. A smaller portion of the incorporated city of Atlanta lies in DeKalb and the major portion in Fulton County. Most of the people in the county live in unincorporated areas of the county rather than in the few small cities. As a consequence the county government performs many functions usually the responsibility of cities in addition to its usual county functions.

During the county government's last ten years they have been beset by many problems. The county's population climbed from 256,782 in 1960 to 415,387 in 1970. Some measure of growth of the county government is reflected by the change in the county tax levy which went from $13,535,000 in 1960 to $50,406,000 in 1970.

During the period 1967 through 1969 the county government experienced a serious fiscal crisis, due to some considerable extent to the inadequate financial reporting system. At the start of the crisis period at the end of 1966 the annual audited financial statements showed the following:

General Fund Balance		$2,959,776
Cash Balance	$2,619,368	
Liabilities	1,351,875	
Cash Surplus		$1,267,493

During 1967 the accounting year was changed from a calendar year to a fiscal year ending 30 June. No audit report or financial statements were issued for the eighteen month period from 31 December 1966 to 30 June 1968.

The financial statements as published on 30 June 1968 showed the General Fund Balance to be almost $5 million (see Table 8).

A new administration was elected in the Fall of 1968 to take office on January 1, 1969. A new chairman of the board of county commissioners, a "reform" candidate, was elected. The chairman as the chief executive officer appointed the county's first professional manager. This was a step long overdue. The new administration and manager found to their dismay that the financial cupboard was bare. The new administration requested an audit for the six months period ending December 31, 1968. The audited financial statement showed the General Fund to have a deficit of $6,250,877. When news of the county's financial problems were released, charges and counter charges flew right and left. The fiscal responsibility of the previous administration became a hot political issue. The DeKalb Republican Party termed the deficit fiscal chicanery. They issued a statement saying that using the same audit report they came up not with a deficit but a surplus of $56 million. (When

TABLE 8

DeKalb County, Georgia
General Fund Balance Sheets Summary

	6/30/68	12/31/68
Assets:		
Cash and Short Term Securities	$ 898,511	$1,061,108
Receivables:		
Taxes and Assessments	12,785,654	1,146,428
Due From Other County Funds	1,838,673	219,575
Other Receivables	373,372	244,955
Total	$15,896,210	$2,672,066
Liabilities	$10,186,628	$8,457,164
Deposits	213,457	141,155
Reserve for Self Insurance and Encumbrances	589,896	319,614
Available Fund Balance	4,906,229	(6,250,877)
Total	$15,896,210	$2,672,066

DeKalb County, Georgia
Statement of Changes in Available Fund Balance

	18 Months	6 Months
Fund Balance Beginning of Period	$ 2,959,776	$4,906,229
Add:		
Excess Revenue Over Expenditures	1,700,964	
Other	554,245	308,756
Deduct:		
Reserve for Encumbrances	308,756	88,677
Excess Expenditures over Revenue		8,174,177
Other		3,203,008
Fund Balance End of Period	$ 4,906,229	$(6,250,877)

Source: * DeKalb County, Georgia Financial Reports

questioned how they were able to do this, they said they had added all assets for all funds and subtracted all liabilities.) Supporters of the previous administration started a serious drive to recall the new chairman. The drive eventually failed, but not before thousands of signatures were collected.

Based upon analysis of the financial reports, supplementary records, and newspaper articles, as well as interviews with concerned parties, the writer was able to determine the following points.

Statements of the GOP to the contrary, the county had no operating funds and was forced to borrow over $7 million. For a while, the county was almost on the verge of bankruptcy. The legal debt limit had been reached in the county and the county was unable to float bonds. The county manager finally worked out a slightly illegal plan whereby he would pay the operating expenses with warrants. The banks would honor these but hold them at interest. The debt is gradually being paid off over a four year period. A special property tax levy was raised for retirement of the debt and interest.

Financial reports are supposed to transmit information but the messages these reports transmitted apparently varied considerably from party to party. The citizens of the area are still not quite sure what happened and who was right. The confusing presentation of the financial reports and the contradictory statements by present and former officials left citizens thoroughly bewildered. What they could see is that the June 1968, financial report made by one administration showed

a General Fund "surplus" of almost $5 million, six months later a financial report by a new administration shows the same fund to have a deficit of over $6 million. Both statements had been audited by the same firm of certified public accountants who had attested in both cases that the statements fairly presented the financial position of the county. Based on the size of the recall vote and letters to the editors many county residents still believe the deficit was something cooked up by the new administration to raise taxes.

On the whole the board of county commissioners appears to have been little better informed than the citizens. The system was consistent to the extent that the few inadequate internal reports reflected the same misleading data as the published financial reports. Some commissioners appeared dumbfounded at the later unfolding of events. Although speculation was rife, there appears to have been nothing illegal in the actions of the board of county commissioners during the 1967-1968 period. At least nothing for which they can be brought to trial.

The published financial reports, on the surface at least, have an official substantial look. Each report printed on bond paper runs almost a hundred pages and is filled with financial statements and statistical tables made in approved form. The county had been awarded the Municipal Finance Officers Certificate of Conformance in 1964 and this is prominently displayed in each report. Each report includes a letter from the CPA firm auditing the books.

It proved impossible either to reconstruct exactly what had occurred, or to determine if the breakdown was willful or result of incompetence and the tremendous growth in the government. The incumbent administration does seemed to have tried to paint at the least an overly optimistic picture of the county's financial soundness to aid in their reelection. The incoming administration was determined to paint as dark a picture so that no blame would rub off on them. The incumbent administration unwisely had cut the property tax rates for both 1967 and 1968. Based on the expenditures made they should have been raised. The quest for an optimistic picture influenced the June 30, 1968 statement so that a biased picture was published. The revenues and expenditures estimated, interfund transfers, and the manner of presentation definitely were slanted to paint a rosy picture.

One could ask at this point: Isn't this the role of an independent auditor to see that a subtle bias does not creep into the statements? The same accounting firm in each case audited the financial statements. In each case they gave what amounted to an unqualified approval at least in the eyes of most readers. In retrospect, although not being privy to the firm's work papers, they seem to have verified that the entries were made to justify the figures in the ledgers, and that indeed the assets, at least the tangible ones, and the liabilities did exist. The General Fund statement of revenues, for example, reports revenues for the twenty-four month period ending December 31, 1969 while the statement of expenditures

reports the expenditures for only the eighteen month period ending June 30, 1968. This is noted in a footnote but the extent of the effect this has on the entire financial picture is glossed over. It also appears as if some considerable portion of the revenue should have not been accrued until the next period.

Reconstructing the fund balances on a basis of the cash flow, it appears as if the deficit at the end of 1967 was approximately $1 to $2 million and by June 30, 1968 had reached about $5 million. The county went back to a cash basis for accounting, the county manager being convinced that the accrual basis is too open to manipulation.

There are a number of lessons that can be learned from the analysis. During a time of organizational stress, in DeKalb's case an exceptional rate of growth, an effective information flow becomes of vital importance in maintaining organizational viability. The data transmitted through the financial reporting system failed to meet important organizational needs. First and perhaps most important, the reports conveyed incorrect information to the board of county commissioners in their budget-decision making roles. Second, the reports provided an ineffective control mechanism for expenditure control. Third, the reports proved ineffectual in aiding citizens in evaluation of their local government officials.

The reports present an interesting contrast. On the surface at least, the reports closely conformed to the reporting

requirements of the National Committee on Governmental Accounting. In practice the reports had a number of serious inadequacies. The reports did not provide a comprehensive, composite picture of the entity as a whole. This is a fault often raised against reporting under the fund concept. Combined statements were used but were buried in the back of the report. As per the National Committee recommendations, the balance sheet provided no interfund consolidations. The readers were confronted with an array of data but had no way of determining which resource listings were restricted and which were unrestricted in use. The report showed no comprehensive analysis of working capital or cash flow showing beginning balances, period flow, and ending balances. Consequently, the financial liquidity could not be evaluated. The report provided no satisfactory means of evaluating the efficiency or effectiveness of the elected resource controllers. The reader was not only unable to determine what was accomplished for the resources utilized, but was unable to judge how successful the board of commissioners was in managing the budget. A sizeable deficit was masked as a surplus.

From personal observation the writer has noted that many counties and cities have financial systems no more adequate than DeKalb's at the time the financial crisis occurred. In most cases they limp along without occurring disaster, using a widely practiced form of fiscal incrementalism. Operational expenditures and revenues are held within a few percentage

growth points of the previous year. Major capital expenditures are financed by separate bond issues. DeKalb varied from the pattern because the exceptional growth pattern altered the expenditure pattern; and the revenue inflow was not adjusted to meet the changing operational requirements.

CHAPTER VI

CONCLUSION

This chapter has two objectives. First a summary of major findings of the research and analysis detailed in previous chapters is presented. The second objective of this chapter is to formulate and present an alternative set of accounting principles to fill the current needs of local governments.

Historical analysis showed that the development of local government accounting has been shaped by numerous factors. The changing needs of the organizations served by the accounting systems, pressures generated by reform movements, shifting intergovernmental relationships, and development of new accounting techniques and procedures in the private sector have all interacted in the past on the development of local government accounting. A clear evolutionary path is not discernible; nor is there any suggestion of a final equilibrium state. Neither is it evident that this "trial and error" process has resulted in accounting principles which are more valid than rejected alternatives.

Future developments in local government accounting will also be subject to the same type of interaction of

environmental factors. The continuing growth of local government expenditures, the changing funding pattern, and improvement in information handling equipment and associated software will all effect its evolutionary path.

Analysis of the actual accounting practices and principles of Georgia local governments made a number of points quite clear. The findings of the study done in Georgia are not isolated instances but are firmly substantiated by research done in other areas. The major findings are summarized below.

> Local government has developed into a complex system of many overlapping and interrelated units operating within a single county area. These various units prepare financial reports following different sets of principles and of varying shades of effectiveness.
>
> The accounting principles followed, differ significantly between classes of local government units. There was continuity of principles within a class of units only when intergovernmental regulation was present, as when prescribed by a funding agency.
>
> When actual local government financial reports were measured against the standards set by the American Institute of Certified Public Accountants and the National Committee on Governmental Accounting, significant deficiencies were found.

> The particular set of accounting principles followed by a local government unit depends on such factors as its size, location, rate of growth, and functional role.

Residents of a county area receive services from, contribute resources to, and participate in decisions of many individual units. It would take an expert trained in governmental accounting hours of hard labor to make sense out of the varying financial reports of these units. The average citizen will only be confused and misled by existing reports.

The major organizational effort aimed at improving governmental financial accounting and formulating applicable accounting principles has by default been the province of the Municipal Finance Officers Association and the organization they have sponsored, the National Committee on Governmental Accounting. Through the medium of the National Committee an attempt has been made to provide both a forum for discussion and a means of gaining idea consensus. Their publications and efforts have dominated the field of governmental accounting. The very nature of their structure has led to recommendations for a virtually static system and for many years has stifled advancement. The principles of accounting for governments, as advanced in their official publications (summarized in Appendix I) have remained virtually unchanged for over thirty years. Their recommendations have resulted in preservation of the status quo, inadequate for a changing environment.

The 1968 publication of the National Committee includes their most recent, revised set of governmental accounting principles. These principles continued the trend of prior issuances and have changed but slightly from previous recommendations.

The quest for financial reporting principles has not been confined to the Municipal Finance Officers. Other major professional organizations have endeavored through various approaches with different degrees of success to formulate acceptable sets of accounting principles for both the private sector and the broad spectrum of not-for-profit organizations.

The major studies done on the financial reporting of not-for-profit organizations, in which group local governments are included, have generally arrived at similar conclusions. Studies of accounting for not-for-profit organizations have found that the reporting is usually very poor by any reasonable standard, that the reports to be of any use must expand beyond the concept of reporting on public stewardship, and that the financial reports of these organizations would be significantly improved if the principles followed more closely coincided with those utilized in the private sector. None of these studies has put forth a comprehensive set of accounting principles that would have application to local government accounting.

Considerably more research and writing has been done on accounting principles for the private sector. These principles have to date been concerned with measuring revenue realized within a particular fiscal period and matching this with the

expenditures necessary to produce this revenue. As such, the principles developed for the private sector are not transferable as a set to the public sector.

As the research in this study detailed, several approaches to formulating accounting principles for the private sector have been taken with varying success. Generally one of two alternative modes was used in formulating these sets of principles. One approach has been to set forth what could be termed "descriptive" principles. Under this approach, the set of accounting principles formulated is based on accepted "good" practices. When followed by an organization these accounting principles would lead to financial reports that conform substantially to currently accepted financial reporting practices.

Another approach to principal formulation is to set forth what could be termed "prescriptive" principles. Under this approach the authors of the principles have determined by various means that current good practices have a substantial deficiency or deficiencies. They then have formulated a set of accounting principles that prescribe a course of action that would differ from existing practice. If followed, these prescriptive financial accounting principles would result in financial reports that would differ from currently accepted good practices.

This study will explore both approaches to accounting principle formulation.

Descriptive Principles

As our survey of literature has indicated, the accounting principles promulgated by the National Committee on Governmental Accounting are the nearest approach to a descriptive set of accounting principles of local governments now existing. However, as previously noted (see the Summary of Chapter II) the National Committee's principles have serious faults even as a descriptive set.

Paul Grady's inventory of generally accepted accounting principles in the private sector is the most widely accepted (by practitioners) set of descriptive accounting principles. On the following pages the writer has formulated a set of principles for financial reporting of local governments based on actual practices. As a frame of reference and for purposes of comparison, the same general framework used by Grady (see Appendix II-I) was utilized. Where principles between the public and the private sector are relatively the same, similar wording was incorporated.

Both Grady's publication and that of most other authors have set forth not only principles of accounting but also basic concepts or postulates. These are generally defined as the basic assumptions concerning the environment in which accounting must operate. The analysis of local government financial reporting reveals that these financial statements also conform to certain basic environmental assumptions. They are very similar in many instances to those followed in the private

sector but not by any means identical. The most significant basic concepts for local government accounting are shown on the following pages.

Basic Concepts of Local Government Accounting

a. Money measurement.

A record is made only of those facts that can be expressed in monetary terms. The same concept is prevalant in accounting for private organizations. As is also the case in private organizations this poses one of the severest handicaps in integrating the presentation of financial data into the total information system for effective planning and control.

b. Continuous organizational existence.

This is similar to the going-concern concept in the private sector. Unless there is good evidence to the contrary, accounting assumes the organization will continue to operate indefinitely. Where particular activities or projects are to be of a limited nature and time, in governmental accounting, usually a separate temporary fund is set up just for that activity. The concept perhaps does not have the same import in public organizations as in the private sector, but still significantly affects financial presentations.

c. Materiality

The accounting system does not record or report a great many events which are so insignificant that the work of recording or reporting them is not justified by the usefulness of the results. This concept is also followed in the private sector. In the public sector, materiality of presentation is sometimes affected by legal requirements. For example, some units are required by statute to include in reports long lists of everyone with an outstanding real property tax bill no matter how small the amount.

d. Consistency

This concept requires that once an organization has decided on an alternative method, it will treat all subsequent events in the same character. Generally this concept is followed, but adherence to this rule is not universal. This appears to be the most frequently violated concept by public organizations.

e. Dual-aspect concept

In all but the relatively small units, the basic double entry bookkeeping system which records two aspects of each event (assets and equities) is used.

f. Cost concept

Resources owned by an organization are called in

accounting terminology assets. An asset is ordinarily entered on the accounting records at the price paid to acquire it or its cost. Although the real worth of an item may change with the passage of time, the accounting measurement of the asset will continue to reflect its cost at the time of acquisition. Local governments handle the details of asset accounting in a number of ways; in almost all cases though assets are recorded at cost and remain on the books at that figure until disposition.

g. Accountable entity

In accounting for organizations, the accounts are kept for entities as distinguished from persons associated with the entities. Generally an accountable entity is one with an independence of existence in its own right with separate and distinct activity. Local governments often create a multitiered structure of numerous entities, with each entity being accounted for by a separate fund. Although the concept of entity differs somewhat between public and private organizations, it is no less important in the public sector.

The methodological rules reviewed were those major concepts which could be confirmed by direct observation. This list does not include some concepts on both Grady's and Moonitz's lists. The list does not include concepts not verifiable from actual financial reports such as conservatism (Grady), or

normative postulates such as "stable monetary unit" (Moonitz) which are not practiced.

One other postulate I have not included is that of the law. The law has been listed as a postulate by a number of authors. The law is, however, a pervasive environmental fact. There is no enterprise that is free of the necessity to observe the law, whether it be public or private. If the law was included as a postulate, so perhaps should the fact we use a decimal system of arabic numerals, or that we normally write from left to right and from top to bottom of a page.

The descriptive principles for local government accounting, as was also done in the Grady study, are grouped by like kinds and an objective is provided for each grouping. The following pages contain a complete descriptive set of descriptive local government accounting principles.

Local Government Accounting Principles (A Descriptive Set)

Objective A. Account for the budgeted and actual revenues and expenditures in such a manner as to present fairly the legal accountability by fund for the fiscal period.

Principle A-1. Revenues and expenditures reported for the fiscal period must not be materially understated or overstated. A proper accounting cutoff at the beginning and ending of the period must be made.

Principle A-2. A clear indication must be made of the basis of accounting (cash, accrual, etc.) for the revenues and expenditures of each fund.

Principle A-3. The revenues and expenditures reported must reflect proper distribution by appropriate fund to accurately reflect the operations of each fund.

Principle A-4. Appropriate comparison by fund must be presented in which forecasted revenues as budgeted are matched with actual revenues realized in the fiscal period for all major categories.

Principle A-5. Common expenditures applicable to two or more reporting categories in one or more funds should be distributed in an appropriate manner.

Principle A-6. In reporting revenues, major dollar amounts of revenues realized from nonrecurring sources should be properly identified and categorized as such.

Principle A-7. Expenditures incurred during the fiscal period for the acquisition of capital assets should be properly identified and appropriately categorized as such.

Principle A-8. When expenses include charges for depreciation of fixed assets such amounts should be clearly identified as such.

Objective B. Account for the balances of the various funds and the capital investments as represented by General Fixed Assets in a meaningful manner on a cumulative basis and as to changes during the period covered. The account and fund structure of a local government are designed to meet statutory

and charter requirements and to portray significant financial relationships.

Principle B-1. For reporting purposes, the public capital investment in the organization as represented by the various fund balances and the General Fixed Asset Group of accounts must be properly identified and categorized.

Principle B-2. Source and amount of any changes in fund balances and the fixed asset group of accounts occurring during the period should be appropriately recorded and accounted for.

Principle B-3. Interfund relationships should be reported in such a manner as to prevent erroneous conclusions.

Objective C. Account for the assets owned by the local government in a meaningful manner properly segregated by fund so that when considered with the liabilities and fund balances there is a fair presentation of the financial position of the local government both at the beginning and end of the period. It should be understood that the balance sheet does not purport to show present market value or replacement cost of assets listed.

Principle C-1. All assets owned by the organization must be appropriately segregated by proper fund or account group.

Principle C-2. Items classified as current assets should be carried at not more than is reasonably expected to be realized within one year. Receivables should be reduced by allowance accounts to cover expected losses in collection.

Principle C-3. Receivables representing amounts due from other funds within the organization should be so identified and the nature of any restrictions upon fund transfer clarified.

Principle C-4. Capital assets should be carried at cost of acquisition, cost of construction, or appraised value if donated. Cost of land should ordinarily be shown separately. Proper yardsticks should be established so that consistent distinction may be made between capital assets and operational and maintenance expenditures.

Principle C-5. When final disposition has been made of capital assets, both the appropriate asset account and the fund balance should accordingly be reduced by the cost of the item no longer in service.

Principle C-6. Investments in marketable securities should be carried at cost and when quotations are available, the aggregate quoted amounts should be disclosed.

Principle C-7. The nature of any significant restrictions on the use of any asset or group of assets must clearly be indicated and such assets should be separately accounted for.

Principle C-8. When the fixed assets of a fund are depreciated, the asset's presentation on the balance sheet should include both the original cost and the accumulated depreciation to date. A clear indication should be given if the replacement has been funded.

Objective D. Account for all legal liabilities in a meaningful manner in order that their summarization, considered together with the statements of fund balances will fairly present the financial position of the local government at the beginning and end of the period.

Principle D-1. All known liabilities must be recorded regardless of whether the definite amount is determinable. If the amount cannot be reasonably approximated the nature of the liability should be disclosed in a footnote to the balance sheet.

Principle D-2. A proper segregation should be made between current liabilities due within one year and long term liabilities in which principle amounts are due over one year from the end of the current fiscal period.

Principle D-3. Long term liabilities should be adequately described and sinking fund requirements, rate of interest, and dates and amounts of principle and interest payments shown.

Principle D-4. Reported liabilities must be properly segregated by fund.

Principle D-5. Contingent liabilities of importance should be disclosed.

Objective E. Financial statements should comply with the applicable reporting standards included in generally accepted auditing standards. Reporting should be performed on a fund basis.

Principle E-1. The generally accepted reporting standards applicable to financial statements as set forth in chapters 7, 8, 9 and 11 of the Statement on Auditing Procedure No. 33 are incorporated in this listing.

Principle E-2. A separate, complete, self balancing group of accounts should be established for each fund or account group required by law or sound financial administration. All ledger accounts and subsidiary records necessary to clearly account for the operations and fairly present the financial condition of each fund must be maintained.

Principle E-3. The account balances of separate funds must not be so consolidated in reporting so that an erroneous financial picture is presented.

Principle E-4. A common terminology and account classification should be utilized throughout the accounts and the financial reports.

The set of accounting principles presented on preceding pages is descriptive in that it is based on current practices. If the principles were followed, the resulting financial reports would conform to accepted good practices. A close examination of these descriptive principles reveals several important points.

First, these principles do differ from those recommended by the National Committee on Governmental Accounting on several important points. The principles formulated in this study are more inclusive and provide a much more effective guide to

accepted financial reporting. National Committee recommendations, as previously noted, treat primarily those areas that differ between the public and private sector. This set defines the basic objectives the financial reports are to meet and lists all the major principles necessary to meet those objectives. The National Committee's recommendations refer but indirectly to some more encompassing existing but indefinite set.

The descriptive principles formulated for this study make adequate provision for existing varying practices. The principles set up by the National Committee are heavily slanted toward accounting and financial reporting for large municipalities. The fund structure, varying bases of accounting, depreciation rules, and other major points are patterned in National Committee principles for a model designed for this particular type of government. The descriptive principles formulated for this study would be equally applicable to all types of local governments. For example, in its financial reporting a unit would be required to clearly indicate the basis of accounting utilized in each fund. They would not be required to conform to a particular basis for that fund. Under present legal and administrative requirements, the basis of accounting is often prescribed.

Second, overall financial reporting in most local governments would be significantly improved if the descriptive principles formulated in this study were widely adopted. They would form a more effective guide to reporting on what is

considered currently accepted good practice. Studies of actual reporting practices show that existing principle sets have generally not performed this task.

Third, the reports would still primarily be useful in determining legal stewardship. These financial reports would have limited application for planning and control. The financial statements of the General Fund of a municipality would be similar to those shown in Appendix I which are now considered to be prepared in accordance with "good" practice.

As this study has depicted there are major shortcomings and inadequacies in local government financial reports prepared under existing sets of accounting principles.

First, the accounting principles of local government financial reporting do not appear to have evolved sufficiently to meet the changing needs of the organizations they serve. Their evolution has been subject to the pressure of various factors such as intergovernmental funding and conservative professional group beliefs that have shaped development.

Second, the most significant effort at promulgating an official set of principles has been that of the National Committee on Governmental Accounting. As the research showed these principles were lacking in a number of key areas:

> they were generally incomplete, relating mostly to areas where public and private practices differ;
>
> they were relatively narrow in scope, being designed primarily for large municipalities;

they presented a highly segmented, fund structured picture of the resources and operations of a unit;

they presented a sometimes confusing and misleading financial picture because of the various bases of accounting and depreciation used.

Third, the study of local government accounting practices showed that the accounting principles of the National Committee have apparently not provided an effective guide to "good" practice. With the exception of relatively large cities, most local governments do not conform to National Committee accounting principles. Local government financial reporting as it is practiced has a tendency to present a confusing and misleading picture. Judged against the existing standards of professional organizations local government financial reporting can be considerably improved.

Fourth, the descriptive principles, as formulated on the preceding pages, while a more effective guide to good practice, still have significant limitations on their use. If these accounting principles were adhered to, although they would present a satisfactory picture of legal stewardship, they would not:

present a unified report of the total resources or operations of the organizations because of the fund structure;

present an accurate report of the resources consumed within the reported time period because of the varying bases of accounting used and the varying treatments of depreciation;

present a report of how efficiently the governmental unit had utilized the resources available to provide public services;

present a report of how effectively the resources had been utilized in meeting the planned goals and programs of the governmental unit.

Prescriptive Principles

The basic approaches utilized in formulating the descriptive and prescriptive principles are significantly different. Descriptive principles are formulated by taking accepted accounting practices as given and then distilling from that practice a set of accounting principles which if followed will lead to that practice. As witness the principles recommended by the National Committee, this leads to a virtually static system.

An entirely different approach was taken with the prescriptive principles formulated in this study. First, an examination was made of the broad problem area (local government financial reporting and the accounting principles applicable to that field). This examination included a review of: historical development, major studies, and actual practices in local government financial reporting. The shortcoming of existing principle sets, and the needs of users for financial data were examined in the light of our current environment.

Based on the research for this study, the contention of the writer is that the functional role which the financial reports should play must be more clearly defined if they are to perform an effective role within the accounting-information system. In formulating the prescriptive principles in this study, the following assumptions regarding the role of financial reports were made.

One - Financial reports are important, but important as one segment of the total accounting-information system of an organization. A primary objective of this system, although not the only one, is the communication of significant economic data relating to the organization. Financial reports should play a major functional role in the system in accomplishing this objective.

Two - Formal, general purpose financial reports of the system will be designed for communication with two major groups (a) the policy setting and legislative set of users as governing boards and city councils, and (b) the general public. The other external users must either utilize the reports as fashioned for the primary user groups or request special reports.

Three - The formal, general purpose financial reports have a specific role to play. This role is to assist in communicating a comprehensive historical picture of the legality, effectiveness, and efficiency of organizational resources applied to programs planned to meet organizational objectives. The financial reports will be designed to portray within economic limits as accurate and as objective an array of data for this purpose as is possible. Users may utilize the data for other purposes at their own risk.

In selecting the principles that would be required to meet these assumptions, based on the research performed for this study, the following criteria were used.

First, the principles formulated must be equally applicable to all types of local governments. If adopted there

should be but one set of accounting principles upon which financial reports of all classes of local government units would be based. As research in this study has shown, accounting principles now vary between and among various classes of local governments and in some cases on specific principles at all are apparently followed. This makes effective analyses of financial statements by users almost an impossibility. Utilization of this prescriptive set would mean users of local government financial reports would be faced with one known set of principles for all local government financial reports.

Second, these principles should call for identical treatment in identical situations between classes and within a class. One of the problems of existing practice is the diverse accounting methodology used in different funds and different classes of units. For example, the National Committee's latest set of principles calls for three different bases of accounting in different funds. The report user must now contend with varying methodology combinations in different financial reports; many of which are not clearly spelled out. Under the prescriptive principles one basic methodology should apply to all local government reports.

Third, the financial reports should account for utilization of all assets. Many local government financial reports now report only cash flow or a modified cash flow. Their financial statements ignore the expense from utilization of plant and equipment assets. The prescriptive principles should

account for use of all resources through established depreciation accounting procedures.

Fourth, the financial reports should match resource input and output through established accrual accounting procedures. One basis of accounting should be used for all reports rather than three. Activity and corresponding resource utilization should be reported for specific time frames. Local government accounting now reports on a cash basis, accrual basis, and numerous forms of modified accrual.

Fifth, the reports should present a unified financial picture both by organization and major program. Local government financial reports are now made by fund on a stylized basis. This manner of presentation makes it difficult if not impossible to perform a comprehensive analysis of the efficiency or effectiveness of either the organization as a whole or of individual intradivisional programs.

Sixty, these financial reports should feature extensive use of comparative data. Current year actual performance should be compared with prior year figures, budgeted figures, and when available comparable data from other organizations. The use of comparative data in local government financial reports is now extremely limited, making effective comparative analyses almost impossible.

Seventh, the financial reports should feature wide use of descriptive verbal text, and other quantitative data to supplement the conventional dollar reporting. The total verbal, quantitative, dollar data should be presented in sufficient detail

to enable the user to effectively utilize the report for the purposes it is prepared. This may include such data as explanations of significant variances, program descriptions, program goals, changes in statutes or administrative regulations affecting the financial picture presented, quantitative measures of output, and verbal activity descriptions.

Eighth, the accounting techniques and methodology incorporated through the principles should be technically and economically feasible. For this reason the writer has excluded such concepts as common dollar value statements, periodic reappraisal of fixed asset values, and adjustment of receivable balances for the time value of money. The concepts incorporated in these principles should be basically tried and proven in the private or some segment of the public sector.

Based on the foregoing assumptions and criteria, a set of prescriptive principles for local government financial reporting is presented on the following pages.

Alternative Accounting Principles for Local Government Financial Reporting on Legality, Effectiveness, and Efficiency of Resources Utilized

Revenues

* All revenues realized during the period must be summarized, categorized, and reported by major source.
* The actual revenues realized during the period and those forecast for the period must be accounted for in such a manner that comparable figures for the period can be reported for all major sources.

* Major variances between forecast and actual revenues realized must be adequately explained in the financial report.
* Suitable comparison must be provided between actual revenues realized in this period and those revenues realized in previous periods.
* Restrictions on use of major revenue sources must be adequately noted and explained.
* Supplementary data must be provided for each major revenue source to provide data on such factors as change in taxable base, tax rate, or governing statutes.
* Accounting and reporting for public enterprises such as utilities must clearly differentiate between gross revenues and the net revenues (gross charges for services rendered less operating expenses).
* Non-revenue sources of funds such as proceeds of bond sales or intraunit fund transfers must be clearly accounted and reported as such.
* Accounting and reporting for the proceeds from sales of fixed assets must clearly indicate the gain or loss on the sale of such assets.
* Summaries of the funding plans of major programs must be provided when necessary for program evaluation.
* Proper accounting must be made for deferred and accrued revenues so revenue realized can be accurately reported.

Expenses

* All expenses must be accounted for by cost category, responsibility center, and programs, so that proper combinations by various sets of reporting purposes can be made.
* All expenses must be accounted for in such a manner that comparable budgeted and actual expenses incurred can be accounted for by major responsibility center.
* Major variances between budgeted and actual expenses incurred must be adequately explained in the financial report.
* Suitable comparison must be provided between actual expenses incurred in the reporting period and expenses incurred in previous periods.
* Accounting and reporting must be accomplished in such a manner that it is possible to make a clear distinction between outlays for capital items and operating expenses and between recurring and nonrecurring costs.
* Proper accounting must be made of deferred and accrued expenses and depreciation of fixed assets so that expenses incurred can be accurately reported on an accrual basis.
* When reporting program costs, the actual expenses incurred and those projected must be presented in such a manner as to provide the data necessary for program evaluation.

Assets and Liabilities

* Assets and Liabilities must be reported by descriptive account title and properly summarized by category.

* Receivable as reported should adequately reflect allowance for uncollectible accounts. When necessary supplementary schedules should be prepared to provide data on receivables by type and the amounts of uncollectibles relating to type and previous time frames.
* Amounts reported for inventories should reflect only useable items in stock at cost. Perpetual inventories must be subject to periodic verification and variances adequately accounted for. Supplementary schedules should be provided as required to provide pertinent data on major categories of inventories and the basis of pricing.
* Fixed assets must be accounted for at cost less accumulated depreciation recorded to date. Proper guidelines must be provided for capitalization.
* Long term liabilities, such as bonds, must be reported at face value. Supplementary schedules showing dates and amounts of principle and interest payments must be prepared as required.

Financial Reports

* Costs for intra-unit organizational support must be allocated to agencies providing public services.
* Financial reports on public services provided by the local unit must include quantitative measures of equivalent volume together with appropriate period, prior period, and budgeted costs. Comparable unit costs including those of similar organizations should be reported when feasible.

* Adequate narrative text must be included in program analysis reports to relate performance to program goals and organizational objectives.
* Although the primary purpose of the financial report will be focused on economic activities of the period, prior period actual, future period estimated and multi-year budgeted figures should be included when necessary to present a comprehensive financial picture of a program.

An illustrative local government financial report prepared following these prescriptive accounting principles is shown on the following pages. The unit used in the illustration is a multi-function urban local government.

Figure 1 is an organizational revenue statement. This shows for each major revenue source: (a) revenue forecast for the period; (b) revenue realized during the period; (c) variance of the forecast from the actual revenue realized; (d) actual revenue realized in the immediate preceding period. Additional comparative data would be provided on supplementary schedules in order not to make this statement too confusing.

Supporting schedules for major revenue sources must be prepared and keyed to this summary report. Property tax for example would be supported by a schedule similar to the one shown as Figure 2.

Figure 3 is an organizational expense statement. This shows for each major responsibility center: (a) the budgeted expense of the period; (b) the actual expense incurred during

FIGURE 1

MODEL REVENUE STATEMENT

URBAN CITY
For Year Ending December 31, 1971
Analysis of Revenues Realized This Period

Source of Revenue	1971 Revenue Forecast	1971 Revenue Realized	Variance	1970 Revenue Realized
Property Tax	$	$	$	$
Intergovernmental				
State				
Federal				
User Charges for Service				
Income from Investments				
Miscellaneous Revenue				
Total All Sources	$	$	$	$

Notes: a. Explaining variance between forecast and realized.
b. Explaining changes between realized revenue in 1971 and 1970.

FIGURE 2

MODEL STATEMENT--PROPERTY TAX ANALYSIS

URBAN CITY
Fiscal Year 1971

Assessments	This Period 1971	Prior Periods 1970	1969	1968	1967
Tangible					
Real Property	$	$	$	$	$
Locally Assessed					
State Assessed					
Personal Property					
Intangible					
Gross Tax Digest					
Less Exemptions					
Homestead					
Other					
Net Tax Digest					
Tax Rates (per thousand)					
Operations					
Debt Retirement					
Total					
Total Property Tax Billed					
Collections This Period					
Billed This Period					
Billed Prior Periods					
Total					
Billed This Period					
Uncollected					
Billed This Period Estd.					
To Be Uncollectable					

FIGURE 3

MODEL STATEMENT--EXPENDITURE ANALYSIS

Urban City
For Year Ending December 31, 1971

Responsibility Center	Analysis of Expenses Incurred This Period: 1971 Base Budget	1971 Amendments	1971 Amended Budget	1971 Expenses Incurred	Variance	1970 Expenses Incurred
Operations	$	$	$	$	$	$
Security						
Human Resources						
Transportation						
Community Services						
Total Operations						
Capital Projects						
Project X						
Project Y						
Misc. Projects						
Debt Service						
Total Chief Admin. Officer						
Enterprise						
Operation						
Capital						
Total Expenses Incurred	$	$	$	$	$	$

Notes: a. Explaining variance between budgeted and incurred expenses.
b. Explaining variance between incurred expenses in 1971 and 1970.

the period; (c) the variance of budgeted from actual expenses incurred; and (d) actual expenses incurred in the preceding period.

The expenses are summarized by responsibility center, the major functional agency charged with administering that portion of the resources. In this illustration, there are four operating agencies reporting to the chief administrator. The period expenses incurred by intra-unit service agencies such as legal, finance, and administrative services have been prorated to the "operating" departments. Operating expenses are separated from capital purchases and debt service. A total is shown for the chief administrative officer ultimately charged with responsibility of all but the organization's utility enterprise. Debt service is shown separately as the responsibility of the Finance Officer. A separate total is shown separately for the enterprise manager who reports directly to the city council. Significant variances between budgeted and actual figures should be explained in footnotes. As in the case of revenues only the latest year is shown for comparison, with additional comparative figures being available on separate schedules. Each major category should be keyed to a more detailed supporting schedule. As an example of this an expense analysis for the Human Resources Department is shown in Figure 4.

Columns showing the original budget and a summary of subsequent amendments may or may not be necessary. Some

FIGURE 4

MODEL STATEMENT--DEPARTMENTAL EXPENDITURES

Urban City
For Year Ending December 31, 1971
Analysis of Expenses Incurred This Period Human Resources

Responsibility Center	1971 Budget	1971 Amendments	1971 Amended Budget	1971 Expenses Incurred	Variance	1970 Expenses Incurred
Community Hospital	$	$	$	$	$	$
Public Health Services						
Family Planning Center						
Welfare Services						
Public Education						
Community Relations						
Total Operations						
Capital Projects:						
Project Y						
Misc. Projects	$	$	$	$	$	$

Notes: a. Explaining variance between budgeted and incurred expenses.
b. Explaining variance between incurred expenses in 1971 and 1970.

organizations use budget amendments to cover poor budgeting and mismanagement.

Figure 5 is a statement of the organization's assets and equities. The statement shows current year balances and comparative figures for the preceding year. Receivable are shown less estimated uncollectibles. Fixed assets are shown at cost less accumulated depreciation. Restrictions on use of organizational assets must be noted. Supporting schedules must be keyed to major items, for example, schedules of debt amortization, depreciation of fixed assets, cash flow, and receivables would be included in the report as needed.

The previous organizational reports can be utilized for determining legal stewardship and whether a particular resource manager operated within budgetary limits. For meaningful reporting on efficiency and effectiveness of organizational personnel analysis at program and subdepartmental level is necessary. Figure 6 presents an analysis of a program in the Human Respources Department depicting the type of data that must be presented if the reports are to be utilized for determination of efficiency and effectiveness.

As is evident from comparing the illustrative financial statements on the previous pages with the National Committee's General Fund Statements in Appendix I, financial statements prepared following the prescriptive principles formulated in this study would differ considerably from what is now accepted good practice. The extent to which existing financial reporting by an organization would be significantly altered would depend

FIGURE 5

MODEL STATEMENT--ASSETS AND EQUITIES

Urban City
December 31, 1971
Summary of Assets and Equities

ASSETS	1971	1970	EQUITIES	1971	1970
Current Assets:			Current Liabilities;		
Cash (a)	$	$	Accounts Payable	$	$
Receivables (b)			Customer Deposits		
Tax			Wages Payable		
Enterprise					
Other					
Prepaid Expenses					
Total Current Assets			Total Current Liabilities		
Fixed Assets			Long Term Liabilities		
Land			Bonds Payable		
Public Buildings					
Less Accumulated Dep.			Total Liabilities		
Equipment					
Less Accumulated Dep.					
Roads and Bridges			Public Equity		
Less Accumulated Dep.					
Enterprise Plant					
Less Accumulated Dep.					
Total Fixed Assets			Total Equities	$	$
TOTAL ASSETS	$	$			

Notes: (a) Cash restricted to a sinking fund for debt retirement is $ _____.
(b) Receivables are shown net of estimated uncollectible accounts of $ _____.
(c) Explanation of major changes 1971 balances from 1970.

FIGURE 6

MODEL--PROGRAM ANALYSIS REPORT

Urban City
For Year Ended December 31, 1971
Analysis of the Family Planning Program

Organizational Objective

Provide community services that will aid in effective population control.

Program Description

This program is in the third year of a five year program to build, equip, staff, and operate on a pilot basis a community family planning clinic.

Phase 1 - Feasibility Study - Complete December 1969

Phase 2 - Procurement of Facility - Complete May 1971

Phase 3 - Equip Facility - Complete November 1971

Phase 4 - Administer a pilot family planning clinic for five years (two more years remaining)

Program Goals

a. Provide professional counseling on family planning. Free counseling will be available for all requesting the service. The program will have an outreach function for key client groups.

b. Dispensing free means of birth control to all requesting such service. Provide an outreach service to key client groups.

c. Provide operations for abortions of unwanted pregnancies as requested by consenting adults in a medically satisfactorily manner. A sliding scale of nominal fees to be charged depending on income.

d. Providing operations for vasectomy to consenting adults in a medically satisfactory manner. A sliding scale of nominal fees to be charged depending on income.

Revenue

Listed below is a summary of funds by major source for each year of the program. A federal grant from the Department of Health, Education, and Welfare was received in 1969 to cover 60 percent of the total program cost for the five year period. Funds from the State Department of Health were provided to cover 20 percent of the total cost and the remaining 20 percent is to be borne from local funds. Upon completion of the pilot program, it is expected that the cost of operation will be divided equally between state and local sources.

	Actual			Forecast	
Category	1969	1970	1971	1972	1973
Federal Grant	$	$	$	$	$
State Grant					
Local Contribution					
User Fees					
Appropriation					
Total	$	$	$	$	$

In 1971 due to the wide acceptance of the program, clients'

Figure 6 (continued)

(users) fees were 25 percent greater than forecast. The appropriation by the city council was raised by $25,000 to meet unplanned construction costs.

Expenditures

For analysis the uses of funds have been summarized in the four main phases of the contract.

Phase	Budget	Actual Expenditures 1969	1970	1971	Estimated 1972	1973	Estimated Total	Variance
	$	$	$	$	$	$	$	$
Feasibility Study								
Facility Procure.								
Facility Equip.								
Operation								
Total								

The Feasibility Study was completed by the Urban Life Institute in December 1969 within the budget allotment and has been approved by all parties.

The land for the Clinic was purchased in March 1969 for $_____. The site is located at the corner of Prior Street and Central Avenue in downtown Urban City. Construction of a building to house the clinic was started in September 1969 and completed in May 1971. The construction was awarded by sealed bid to the Center City Construction Company based on

approved plans. In February 1971, it was discovered that no funds had been budgeted for landscaping or parking lots and that no federal or state money was available. An additional $25,000 was requested and received as a budget amendment from the city council for this purpose. All work was completed on the facility in November 1971 and the building was approved by all parties at that date.

A complete complement of medical and administrative equipment was purchased and installed in 1971.

The following is a summary of capital expenditures on this program as they appear on the balance sheet of Urban City.

	Total Cost	Annual Depreciation	Estimated Life
Land	$	$	$
Building (Public)			
Equipment			
Total	$	$	$

Until November 1971 the clinic was conducted in rented quarters. The program has received wider and quicker public acceptance and utilization than anticipated, and consequently operational expenses and clients' fees have been greater than projected. The facility is now completely staffed as follows:

Program Director (M.D.)

Medical Doctors (4) Family Planning Consultants (3)

Registered Nurses (6) Clerical and Maintenance (5)

Figure 6 (continued)

Operational Expenses are as follows:

Category	Actual Expenses 1969	1970	1971	Estimated 1972	1973
Personnel Salaries	$	$	$	$	$
Facility Rent					
Lab. Fees					
Depreciation					
Other Operating Expenses					
Total	$	$	$	$	$

During the year 1971 the following services have been provided at the following costs:

a. Family Counseling

		1971	1970
individual sessions	cost per contact	$ ____	$ ____
group sessions (average ___ persons)	cost per session	$ ____	$ ____

b. Birth Control Devices

clients contacted 1971
1970

items dispensed 1971 unit cost 1971
1970 unit cost 1970
(includes counseling costs)

c. Operations performed for abortion

Number of operations in 1971
Cost per operation in 1971 $ _____

Number of operations in 1970
Cost per operation in 1970 $ _____

(Costs include pre- and post-counseling and all medical attention).

Figure 6 (continued)

d. Operations performed for vasectomy

Number of operations in 1971
Cost of operation in 1971 $ _____

Number of operations in 1970
Cost of operation in 1970 $ _____

The Program Director requests that the report show that _____ cases of venereal disease were discovered and treated in 1971 as the result of examinations made for other purposes.

All phases of the actual operation have been reviewed and approved by both state and federal officials.

on how the reports were now being prepared. The greatest impact would be on multifunctional organizations reporting on a cash basis with many individual funds. There would be considerably less impact on organizations such as hospitals which already adhere to many of the prescribed principles.

For a local government financial reporting system utilizing these prescriptive principles to operate effectively, certain changes must occur in various facets of the existing-information system.

First, the financial reports must play a relatively specific planned role within the system as detailed by the assumptions upon which the principles are based.

Second, some measure of intergovernmental control is necessary if improvement is to occur. Various state and federal agencies must coordinate special informational needs with the general reporting requirements of the local government organization. Statutory and administrative regulation must be provided and adequately regulated to provide adherence to minimum standards.

Third, state societies of certified public accountants, must cooperate in programs to improve the quality of audits and financial reports prepared by practitioners. State societies must work with state officials in educating local government officials as to the requirements for and the limitations of financial reporting.

Fourth, research is needed in several areas if reporting on the efficiency and effectiveness of expenditures is to be

performed. Common information recording and reporting systems for all units of [illegible] class within a state must be developed. Appropriate techniques for depreciation of fixed assets and other technical problems of accrual accounting must be worked out. Realistic quantitative performance standards must be agreed upon for type of function. Improvement must be made in using narratives in financial reporting to clarify and explain figures presented.

Preparing comprehensive, informative financial statements for local governments is now, and under any alternative set of principles will be a relatively difficult and complicated task. In preparing summary statements to show data for the organization as an entity, data can be aggregated and combined just so far and remain informative. If the financial statements are to report on organizational effectiveness and efficiency in a manner that enables the reader to make decisions and judgments, a relatively fine level of detail must be reported. The reader must also have a relatively high level of familiarity with reporting terminology and concepts. Detailed reports will for the most part continue to be used by policy making boards. This makes a public information program vitally important. Financial reports should serve as an information base for reporting to the public through the many varied means available for this type of communication.

For a particular class of units within a state, regulating agencies will have to integrate special and general purpose needs in formulating applicable accounting principle sets.

Some mechanism must also be established for revising principles to meet changing environmental and administrative needs. If interunit comparison is also required in addition to sets of principles, sample statements, charts of accounts and detailed instructions will be needed.

The financial reports prepared utilizing prescriptive principles formulated in this study within limits imposed by cost effectiveness and present information system capabilities in this environment should to a considerable degree help local governments meet current information needs.

Residents of a county area now judge the effectiveness and efficiency of their local governments primarily by random observation. Financial reports prepared under these prescriptive principles could enable them to form more reasoned opinions on the operations of their local governments. A sound voter information program utilizing the data generated in these reports could go a long way toward lifting the cloud of ignorance on local government that now exists. Hopefully in the long run more intelligent voting patterns could result.

The data contained in these reports properly integrated into the total information flow should assist the decision making groups such as city councils and governing boards in their basic management process of planning and controling. With a more inclusive economic picture that could be presented by these financial statements, resource allocations could perhaps be more rational. With the assessment of performance in the reports, the personnel reward-penalty system can become

significantly more effective. With more complete data on program and activity costs, more effective service patterns can be effected.

A high priority in plans to strengthen and recognize local government in the United States must be modernization of local government financial administration and particularly financial reporting. The formulation of a set of prescriptive accounting principles must be a basic step in any plan to improve financial reporting.

LOCAL GOVERNMENT FINANCIAL STATEMENTS

APPENDIX 1

I-A

National Municipal League Local Government
Financial Reports[a] 1899

SUMMARIZED STATEMENT OF RECEIPTS AND EXPENDITURES

	RECEIPTS		EXPENDITURES	
	Ordinary	Extra Ordinary	Ordinary	Extra Ordinary
I. General Government				
1. Executive				
2. Legislative				
3. Law Department				
4. Finance Department				
5. Elections				
II. Taxation				
1. Real Property Taxes				
2. Personal Property Taxes				
3. Poll Taxes				
4. Licenses				
5. Franchise and Franchise Taxes				
III. Public Safety				
1. Police				
2. Fire Department				
3. Jails, Prisons				
4. Health Department				
5. Food Inspection				
6. Regulating Dangerous Pursuits				
7. Sanitary Measures				
8. Miscellaneous				

(Similar breakdowns are provided for Public Charity, Public Convenience, Public Industries, Public Education and Allied Objects, Public Trust Funds, and Indebtedness.)

Totals
Receipts
Brought Down
Total Receipts
Cash in Treasury at Begin. Fiscal Year
Expenditures
Brought Down
Total Expenditures

Cash in Treasury at End of Fiscal Year

[a]L. S. Rose, "Public Accounting Under the Proposed Municipal Programs," Proceedings of the National Municipal League - 1899 (Philadelphia: Dando Printing Company, 1899, pp. 104-06.

I-B

National Municipal League Local Government
Financial Reports[a] 1899

GENERAL STATEMENT OF ASSETS AND LIABILITIES

Assets

1. Available

   Cash in Treasury
   Salable Land and Buildings
   Taxes, Assessments, etc., in arrears
   Other Debts Due
   Other Available Assets (specify)

2. Not Available

   Water Works
   Gas Works
   School Buildings
   Public Buildings
   Parks
   Sinking Fund
   Bad Taxes
   Other Assets Not Available (specify)

Liabilities

Debt

   a. Bonded
   b. Floating

Outstanding Claims

Other Liabilities (specify)

[a]Rowe, "Public Accounting," pp. 110-11.

I-C

National Municipal League Local Government
Financial Statements[a] 1902

I. Consolidated Statement of Revenue and Expenses for the Fiscal Year

Receipts of City from all sources
Balance at Beginning of year

Total

Expenditure of City for all purposes
Balance at end of year

II. General Exhibit of Receipts, Appropriations, and Expenditures for the Fiscal Year

	Receipts	Appropriations	Expenditures
Ordinary			
Extraordinary			
Trust Fund			
Temporary Accounts			
Total			

III. Summary Statement of Receipts, Appropriations, and Expenditures Grouped According to Function of Department for the Fiscal Year

	Receipts		Appropriations		
	Ordinary	Extraordinary		Ordinary	Extraordinary
General Govt.					
Public Safety					
Public Charity					
Public Works					
Public Industries					
Public Education					
Public Debt					
Interest					
Taxation					
Miscellaneous					
Total					

[a] Edward Hartwell, "Report of the Committee on Uniform Municipal Accounting and Statistics," Proceedings of the National Municipal League-1902 (Philadelphia: National Municipal League, 1902), p. 299.

I-D

A. E. Buck--Consolidated Statement of Fund Resources and Obligations--1926[a]

As of . . . . . .

By Fund

Resources	
Income estimated or authorized but not accrued	
Revenues estimated but not accrued	
Special assessments authorized but not accrued	
Bonds authorized but not issued	
Income accrued and estimated collectible	
Taxes accrued and estimated collectible	
Special assessments accrued and estimated collectible	
Against the city	
Against property owners	
Accounts receivable of city owned utilities	
Miscellaneous accounts receivable	
Due from other funds	
Cash available (after deducting immediate demands)	
Recoverable expenditures on assessable improvements	
Stores	
Capital Resources	
Investments	
Cash to be invested	
Total resources	
Obligations and Surplus	
Expenditures authorized but not incurred:	
Unencumbered balances of appropriations	
Unliquidated encumbrances	
Temporary loans outstanding	
Special assessment bonds outstanding	
Due other funds	
Reserves:	
Stores (of expendable funds)	
Working Capital (of working capital funds)	
Total obligations	
Surplus available for appropriation (or deficit)	
Total obligations and surplus	

[a]A. E. Buck, Municipal Finance (New York: Macmillan Company, 1926), pp. 152-53.

I-E

Municipal Finance Officers - 1937[a]

GENERAL FUND BALANCE SHEET

At the Close of the Fiscal Period

Assets

Cash;
  In Depositories
  Undeposited Cash
  Petty Cash

Cash in Closed and Restricted Depositories
  Less Allowance for Above

Cash with Fiscal Agents for Payment of Bonds
  and Interest

Accounts Receivable
  Less Allowance for Estimated Losses

Reimbursable Expenditures

Taxes Receivable:
  Taxes Receivable - Current
    Less Allowance for Estimated Losses

  Taxes Receivable - Delinquent
    Less Allowance for Estimated Losses

Tax Liens
  Less Allowance for Estimated Losses

Due from Other Funds

Due from Other Governmental Units
Accrued Interest on Investments Purchased
Inventory of Supplies
Investments:
  Not Defaulted
  Defaulted

Advances to Other Funds

  Total Assets

Balance Sheet (continued)

Liabilities

Accounts Payable

Judgments Payable

Notes Payable:
  Secured
  Unsecured

Matured Bonds and Interest Coupons Payable:
  Through Fiscal Agents

Contracts Payable

Due to Other Funds

Taxes Collected in Advance

  Total Liabilities

Reserves and Surplus

Reserves:
  Reserve for Encumbrances
  Reserve for Advances to Other Funds

Unappropriated Surplus:
  Available during Next Twelve Months
  Unavailable during Next Twelve Months

    Total Liabilities, Reserves, and Surplus

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[a]National Committee on Municipal Accounting, Bulletin No. 5, (Chicago: Municipal Finance Officers Association, 1937), pp. 10-11.

I-F

National Committee on Governmental Accounting--1951[a]

Name of Municipality
General Fund
BALANCE SHEET
At the Close of the Fiscal Period[a]

ASSETS

Cash

Cash with Fiscal Agents for Payment of Bonds
  and Interest
Temporary Investments (Form 49)
Accrued Interest on Investments Purchased (Form 49)
Accounts Receivable
  Less: Estimated Uncollectible Delinquent Taxes

Taxes Receivable--Delinquent (Form 43)
  Less: Estimated Uncollectible Delinquent Taxes

Interest and Penalties Receivable on Taxes (Form 45)
  Less: Estimated Uncollectible Interest
    and Penalties

Tax Liens Receivable (Form 47)
  Less: Estimated Uncollectible Interest
    and Penalties

Due from Other Funds (Itemized by funds)
Due from Other Governmental Units (Itemize by units)
Inventory of Supplies

      Total Assets

LIABILITIES, RESERVES, AND SURPLUS

Vouchers Payable
Judgments Payable
Matured Bonds Payable
Matured Interest Payable
Contracts Payable
Due to Other Funds (Itemize by funds)
Taxes Collected in Advance

Balance Sheet (continued)

Total Liabilities

Reserve for Encumbrances--Current Year

Unappropriated Surplus (Form 2)

Total Liabilities, Reserves, and Surplus

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[a]National Committee on Governmental Accounting, Municipal Accounting and Auditing (Chicago: Municipal Finance Officers Association, 1951), p. 29.

I-G

National Committee on Governmental Accounting--Financial Statements--1968[a]

Name of Governmental Unit
GENERAL FUND
BALANCE SHEET
December 31, 19

ASSETS

Cash
Investments (Illustration 53)
Interest Receivable on Investments
Accounts Receivable
  Less: Estimated Uncollectible Accounts Receivable

Taxes Receivable--Delinquent (Illustration 51)
  Less: Estimated Uncollectible Delinquent Taxes

Interest and Penalties Receivable on Taxes
  Less: Estimated Uncollectible Interest and Penalties

Tax Liens Receivable
  Less: Estimated Uncollectible Tax Liens

Advance to Central Garage Fund
Due from Parks Fund
Due from State Government
Inventory of Supplies
  TOTAL ASSETS

LIABILITIES, RESERVES, AND FUND BALANCE

Vouchers Payable
Accounts Payable
Contracts Payable
Due to Water and Sewer Fund
Due to Employees' Retirement System Fund
Due to Central Garage Fund
Taxes Collected in Advance
  Total Liabilities
Reserve for Encumbrances
Reserve for Inventory of Supplies
Reserve for Advance to Central Garage Fund
Fund Balance (Illustration 2)
  TOTAL LIABILITIES, RESERVES, AND FUND BALANCE

Financial Statements (continued)

Name of Governmental Unit
GENERAL FUND
ANALYSIS OF CHANGES IN FUND BALANCE
For the Fiscal Year Ended December 31, 19x2

Fund Balance, January 1, 19x2	
Add:	
Excess of Revenues over Expenditures:	
Revenues (Illustration 3)	
Expenditures (Illustration 4)	
Reserve for Encumbrances from 19x1 Cancelled	
Decrease in Reserve for Advance to Central Garage Fund	
Total Balances and Additions	
Deduct:	
Reserve for Encumbrances, December 31, 19x2	
Increase in Reserve for Inventory of Supplies	
Fund Balance, December 31, 19x2 (Illustration 1)	

Name of Governmental Unit
GENERAL FUND
STATEMENT OF REVENUE--ESTIMATED AND ACTUAL
For the Fiscal Year Ended December 31, 19x2

	Estimated Revenue	Actual Revenue	Actual Over (Under) Estimated
Taxes:			
General Property Taxes - Current			
Penalties and Interest on Delinquent Taxes - General Property			
Total Taxes			
Licenses and Permits:			
Business Licenses and Permits			
Non-Business Licenses and Permits			
Total Licenses and Permits			
Intergovernmental Revenue:			
Federal Grants			
State Grants			
Total Intergovernmental Revenue			

Financial Statements (continued)

	Estimated Revenue	Actual Revenue	Actual Over (Under) Estimated
Charges for Services:			
General Government			
Public Safety			
Highways and Streets			
Sanitation			
Culture - Recreation			
Total Charges for Services			
Fines and Forfeits:			
Fines			
Forfeits			
Total Fines and Forfeits			
Miscellaneous Revenue:			
Interest Earnings			
Rents and Royalties			
Total Miscellaneous Revenue			
TOTAL REVENUE			

[a]National Committee on Governmental Accounting, Governmental Accounting, pp. 23-25.

Name of Governmental Unit
GENERAL FUND
STATEMENT OF EXPENDITURES AND ENCUMBRANCES COMPARED WITH AUTHORIZATIONS
For the Fiscal Year Ended December 31, 19x2

	Reserve for Encumbrances 19x1 (1)	Expenditures 19x1 (1)	Credit (Charge) to Fund Balance	19x2 Appropriations Revised (2)	19x2 Expenditures (3)	19x2 Encumbrances (3)	19x2 Unencumbered Balance
GENERAL GOVERNMENT:							
Legislative							
Personal Services							
Supplies							
Other Services and Charges							
Capital Outlays							
Total Legislative							
Judicial (Itemize by Object)							
Executive (Itemize by Object)							
Total General Government							
PUBLIC SAFETY (4)							
HIGHWAYS AND STREETS (4)							
SANITATION (4)							
HEALTH (4)							
WELFARE (4)							
CULTURE-RECREATION (4)							
EDUCATION (4)							
TOTAL							

(1) Where the Reserve for Encumbrances includes amounts encumbered prior to the year immediately preceding (19x1 in this illustration), the first two money columns in this statement should read, respectively, "Reserve for Encumbrances Prior Years" and "Expenditures - Prior Years."

(2) In lieu of this single column, three headings may be used as follows: Appropriations Revisions Final

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Appropriations.

(3) Under appropriate circumstances where the number and amounts of encumbrances are not material, the "Expenditure" and "Encumbrances" columns may be combined into a single column. Where this is done, there must be a proper notation htat the column contains year-end encumbrances as well as actual expenditures.

(4) For illustrative purposes only, functional totals are shown here. In actual practice, each function should include detailed break downs on the basis of subfunctions (if any), activity, and object of expenditure.

ACCOUNTING PRINCIPLES

APPENDIX II

II-A

Accounting Principles--National Committee on Municipal Accounting 1934[a]

1. The accounts should be centralized under the direction of one officer, who should be made responsible for keeping or supervising the keeping of all financial records, and preparing all financial reports.

2. The general accounting system should be on a double entry basis with a general ledger maintained in accordance with the following principles: (a) The accounts should be classified in balanced fund groups; (b) Asset accounts for permanent property not available to meet expenditures or obligations should be segregated from other fund assets and the equity represented by them not included in the current surplus of any fund.

3. The following classification of funds is recommended: (a) general fund, (b) special revenue funds, (c) utility funds, (d) bond funds, (e) special assessment funds, (f) trust and pension funds, (g) agency funds, and (h) sinking funds.

4. The general accounting system should include budgetary control accounts of revenues, expenditures, appropriations, and encumbrances.

5. Revenue should be accounted for through the budgetary control accounts. If revenue is accounted for on an accrual basis by taking into the account each item when it becomes due or a bill is issued for it, the reports should be prepared on that basis. In this case suitable provision should be made for possible losses through inability to collect. If revenue is accounted for on a cash basis, meaning that an item is considered revenue only when it is collected in cash, the reports should be prepared on that basis. In either case, all items of a non-revenue character should be excluded from reports of revenue. Revenues should be classified by fund and by source in accordance with standard classifications.

6. Expenditures should be accounted for through the budgetary control accounts and on such a basis as to take into the accounts all material used or services rendered during a given period. Suitable provision out of the appropriations of the current period should be made for encumbrances for which material or services are not yet received or rendered. Expenditures should be classified by fund, by department, and by activities, and by object, if desired, in accordance with standard classifications.

7. There should be a system of unit cost accounting in which costs are allocated to the various activities in the respective departments. This system should be coordinated with the general accounting system.

8. There should be inventory records of both consumable and permanent property, and the records of property should be subsidiary to and

II-A (continued)

controlled by accounts in the general accounting system. The asset accounts of property should be maintained on the basis of original cost, or estimated cost if the original cost is not available, or, in the case of gifts, the appraised value at the time received. If current valuations are desired for insurance, or statistical purposes, they should be computed independently from the books and not carried into the accounts. It is not considered necessary to account for depreciation of general municipal property, except for unit cost purposes, unless cash can legally be set aside for replacements.

9. The accounting for public utilities or other business enterprises operated by the city should follow the standard procedure employed by similar enterprises under private ownership. The accounting for public institutions such as colleges, hospitals, and libraries should follow the standard procedure employed by such a class of institutions.

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[a]National Committee on Municipal Accounting, Bulletin No. 1, (Chicago: Municipal Finance Officers Association, 1934).

II-B

Accounting Principles--National Committee on Municipal Accounting 1937[a]

1. Accounts should be centralized under the direction of one officer. He should be responsible for keeping or supervising all accounts and for preparing and issuing all financial reports.

2. The general accounting system should be on a double entry basis, with a general ledger in which all financial transactions are recorded in detail or in summary. Additional subsidiary records should be kept where necessary.

3. A common terminology and classification should be used consistently through the budget, the accounts, and the financial reports.

4. The accounts should be classified in balanced fund groups. The group for each fund should include all accounts necessary to set forth its operation and condition. All financial statements should follow this classification.

5. The following classification of funds is recommended: (1) General, (2) Special Revenue, (3) Working capital, (4) Bond, (5) Special Assessment, (6) Sinking, (7) Trust and Agency, (8) Utility. Other funds may be established where specific activities require separate accounting. Cash, whose ultimate use has not been determined, may be included temporarily in the Trust and Agency funds or carried separately in suspense accounts.

6. A clear segregation should be made between the accounts relating to current assets, liabilities, and operations, and those relating to fixed assets and liabilities. Asset accounts for permanent property not available to meet expenditures or obligations should be segregated from other fund assets and the equity represented by them not included in the current surplus of any fund. Revenues should be classified by fund and source; and expenditures by fund, department, activity, character, and object, in accordance with standard classification.

7. The general accounting system should include budgetary control accounts for both revenue and expenditures.

8. As soon as purchase orders or contracts are signed, the resulting obligations should be entered at once as encumbrances of the funds and appropriations affected.

9. The use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical. Revenues, partially offset by allowances for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred.

II-B (continued)

10. Although depreciation on general municipal property may be omitted in the general accounts and reports, it should be considered in determining unit costs if a cost-accounting system is used.

11. The accounting for municipal business enterprises should follow the standard classifications employed by similar private enterprises. Each college, hospital, library, and other public institution should follow the standard classification applicable to its accounts.

12. Inventories of both consumable and permanent property should be kept in subsidiary records controlled by accounts in the general accounting system. The fixed asset accounts should be maintained on the basis of original cost, or the estimated cost if the original cost is not available, or, in the case of gifts, the appraised value at the time received. The computation of depreciation on general municipal property is not recommended, except for unit cost purposes, unless cash for replacements can legally be set aside.

13. There should be general uniformity in the financial reports of all municipalities of similar size and type.

14. Financial reports should be prepared monthly or oftener, to show the current condition of the budgetary accounts and other essential information. At least once each year a general financial report should be prepared and published or otherwise made available for public examination.

15. A periodic audit by independent accountants is desirable.

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[a]National Committee on Municipal Accounting, Bulletin No. 5, (Chicago: Municipal Finance Officers Assocation, 1935).

II-C

Accounting Principles--National Committee on Municipal Accounting 1941[a]

1. The accounts should be centralized under the direction of one officer. He should be responsible for keeping or supervising all accounts and for preparing and issuing all financial reports.

2. The general accounting system should be on a double entry basis, with a general ledger in which all financial transactions are recorded in detail or in summary. Additional subsidiary records should be kept where necessary.

3. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports.

4. The accounts should be classified in balanced fund groups. The group for each fund should include all accounts necessary to set forth its operation and condition. All financial statements should follow this classification.

5. The following classification of funds is recommended: (1) General; (2) Special Revenue; (3) Working Capital; (4) Special Assessment; (5) Bonds; (6) Sinking; (7) Trust and Agency; and (8) Utility. Cash whose ultimate use has not been determined may be included temporarily in the trust and agency funds or carried separately in suspense accounts.

6. A clear segregation should be made between the accounts relating to current assets, liabilities, and operations, and those relating to fixed assets and liabilities. With the exception of working capital, utility, or trust funds, fixed assets should not be carried in the same fund with the current assets but should be set up in a separate self balancing group of accounts. Similarly, except in special assessment and utility funds, long-term liabilities should not be carried with the current liabilities of any fund but should be shown in a separate self-balancing group of accounts. Revenue should be classified by fund and source; and expenditures by fund, function, department, activity, character, and object, in accordance with standard classifications.

7. The general accounting system should include budgetary control accounts for both revenues and expenditures.

8. As soon as purchase orders or contracts are signed, the resulting obligations should be entered at once as encumbrances of the funds and appropriations affected.

9. The use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical. Revenues, partially offset by provisions for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred.

II-C (continued)

10. Inventories of both consumable and permanent property should be kept in subsidiary records controlled by accounts in the general accounting system. The fixed assets accounts should be maintained on the basis of original cost, or estimated cost if the original cost is not available, or in the case of gifts, the appraised value at the time received. The computation of depreciation on general municipal fixed assets is not recommended except for unit cost purposes, unless cash for replacements can legally be set aside.

11. Although depreciation on general municipal fixed assets may be omitted in the general accounts and reports, it should be considered in determining unit costs if a cost accounting system is used.

12. (a) The accounting for municipal business enterprises should follow the standard classifications employed by similar private institutions.
    (b) Each college, hospital, library, and other public institution should follow the standard classification employed by similar private institutions.

13. A periodic audit by independent accountants is desirable.

14. Financial reports should be prepared monthly or oftener, to show the current condition of the budgetary accounts and other essential information. At least once each year a general financial report should be prepared and published.

15. There should be general uniformity in the financial reports of all municipalities of similar size and type.

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[a]National Committee on Municipal Accounting, Bulletin No. 12, (Chicago: Municipal Finance Officers Association, 1941).

II-D

Accounting Principles--National Committee on Governmental Accounting 1951[a]

1. A municipal accounting system must make it possible (1) to show that legal provisions have been complied with and (2) to reflect the financial condition and financial operations of the municipality.

2. If legal and sound accounting provisions conflict, legal provisions must take precedence. It is, however, the finance officer's duty to seek changes in the law which will make such law a harmony with sound accounting principles.

3. The general accounting system should be on a double-entry basis with a general ledger in which all financial transactions are recorded in detail or in summary. Additional subsidiary records should be kept where necessary.

4. Every municipality should establish the funds called for either by law or by sound financial administration. It should be recognized, however, that funds introduce an element of inflexibility in the financial system. Accordingly, consistent with legal provisions and requirements of sound financial administration, as few funds as possible should be established.

5. Depending on the legal and financial requirements mentioned immediately above, the following types of funds are recognized: (1) General, (2) Special Revenue, (3) Working Capital, (4) Special Assessment, (5) Bond, (6) Sinking, (7) Trust and Agency, and (8) Utility or Other Enterprise. This classification of funds to the extent required should be followed in the budget document and in the municipality's financial reports.

6. A complete balancing group of accounts should be established for each fund. This group should include all of the accounts necessary to set forth the financial condition and financial operations of the fund and to reflect compliance with legal provisions.

7. A clear segregation should be made between the accounts relating to current assets and liabilities and those relating to fixed assets and liabilities. With the exception of Working Capital, Utility or Other Enterprise, or Trust Funds, fixed assets should not be carried in the same fund with the current assets but should be set up in a self-balancing group of accounts known as the General Fixed Assets Group of Accounts. Similarly, except in Special Assessment and Utility Funds, long-term liabilities should not be carried with the current liabilities of any fund but should be shown in a separate self-balancing group of accounts forming part of the General Bonded Debt and Interest group of accounts.

8. The fixed asset accounts should be maintained on the basis of original cost, or the estimated cost if the original cost is not available, or, in the cast of gifts, the appraised value at the time received.

9. Depreciation on general municipal fixed assets should not be computed unless cash for replacements can legally be set aside. Depreciation on such assets may be computed for unit cost purposes even if cash for replacements cannot legally be set aside providing these depreciation charges are used for memorandum purposes only and are not reflected in the accounts.

10. The accounting system should provide for budgetary control for both revenues and expenditures, and the financial statements should reflect, among other things, budgetary information.

11. The use of the accrual basis in accounting for revenues and expenditures is recommended to the extent applicable. Revenues, partially offset by provisions for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred.

12. Revenues should be classified by fund and source; and expenditures by fund, function, department, activity, character, and by main classes of objects, in accordance with standard classifications. (See the Committee's publication A Standard Classification of Municipal Accounts.)

13. Cost accounting systems should be established wherever costs can be measured. Each cost accounting system should provide for the recording of all the elements of cost incurred to accomplish a purpose, to carry on an activity or operation, or to complete a unit of work or a specific job. Although depreciation on general municipal fixed assets may be omitted in the general accounts and reports, it should be considered in determining unit costs if a cost accounting system is used.

14. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports.

Standard Procedures

1. The accounts should be centralized under the direction of one officer. He should be responsible for keeping or supervising all accounts and for preparing and issuing all financial reports.

2. A budget should be prepared by every municipality even if not required by law because such budgets are essential to the proper management of its financial affairs. A distinction between the different funds must be made in such budget.

3. As soon as purchase orders or contracts are signed, the resulting obligations should be recorded at once as encumbrances of the funds and appropriations affected.

4. Inventories of both consumable and permanent property should be kept in subsidiary records controlled by accounts in the general accounting system. Physical inventories of both consumable and permanent property should be taken at least annually and the accounts and records should be made to agree with such inventories.

5. The accounting for municipal business enterprises should follow the standard classifications employed by similar private enterprises. Each college, hospital, library, and other public institution should follow the standard classification for such institutions.

6. Financial reports should be prepared monthly or oftener, to show the current condition of the budgetary accounts and other information necessary to control operations. At least once each year a general financial report should be prepared and published.

7. There should be general uniformity in the financial reports of all municipalities of similar size and type.

8. A periodic audit by independent accounts is desirable.

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[a]National Committee on Governmental Accounting, Municipal Accounting and Auditing (Chicago: Municipal Finance Officers Association, 1951), pp. 1-3.

II-E

Accounting Principles--National Committee on Governmental Accounting 1968[a]

1. A governmental accounting system must make it possible: (a) to show that all applicable legal provisions have been complied with; and (b) to determine fairly and with full disclosure the financial position and results of financial operations of the constituent funds and self balancing account groups or the governmental unit.

2. If there is a conflict between legal provisions and generally accepted accounting principles applicable to governmental units, legal provisions must take precedence. Insofar as possible, however, the governmental accounting system must make possible the full disclosure and fair presentation of financial position and operating results in accordance with generally accepted principles of accounting applicable to governmental units.

3. An annual budget should be adopted by every governmental unit, whether required by law or not, and the accounting system should provide budgetary control over general governmental revenues and expenditures.

4. Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

5. The following types of funds are recognized and should be used in accounting for governmental financial operations as indicated.
   (1) The General Fund to account for all financial transactions not properly accounted for in another fund;
   (2) Special Revenue Funds to account for the proceeds of specific revenue sources (other than special assessments) or to finance specified activities as required by law or administrative regulation;
   (3) Debt Service Funds to account for the payment of interest and principal on long-term debt other than special assessment and revenue bonds;
   (4) Capital Projects Funds to account for the receipt and disbursement of moneys used for the acquisition of capital facilities other than those financed by special assessment and enterprise funds;
   (5) Enterprise Funds to account for the financing of services to the general public where all or most of the costs involved are paid in the form of charges by users of such services;
   (6) Trust and Agency Funds to account for assets held by a governmental unit as trustee or agent for individuals, private organizations, and other governmental units;

(7) Intergovernmental Service Funds to account for the financing of special activities and services performed by a designated organization unit within a governmental jurisdiction for other organization units within the same governmental jurisdiction;
(8) Special Assignment Funds to account for special assessments levied to finance public improvements or services deemed to benefit the properties against which the assessments are levied.

6. Every governmental unit should establish and maintain those funds required by law and sound financial administration. Since numerous funds make for inflexibility, undue complexity, and unnecessary expense in both the accounting system and the over-all financial administration, however, only the minimum number of funds consistent with legal and operating requirements should be established.

7. A complete self-balancing group of accounts should be established and maintained for each fund. This group should include all general ledger accounts and subsidiary records necessary to reflect compliance with legal provisions and to set forth the financial position and the results of financial operations of the fund. A clear distinction should be made between the accounts relating to current assets and liabilities and those relating to fixed assets and liabilities. With the exception of Intragovernmental Service Funds, Enterprise Funds, and certain Trust Funds, fixed assets should not be accounted for in the same fund with the current assets, but should be set up in a separate self-balancing group of accounts called the General Fixed Asset Group of Accounts. Similarly, except in Special Assessment, Enterprise, and certain Trust Funds, long-term liabilities should not be carried with the current liabilities of any fund, but should be set up in a separate, self-balancing group of accounts known as the General Long-term Debt Group of Accounts.

8. The fixed asset accounts should be maintained on the basis of original cost, or the estimated cost if the original cost is not available, or, in the case of gifts, the appraised value at the time received.

9. Depreciation on general fixed assets should not be recorded in the general accounting records. Depreciation charges on such assets may be computed for unit cost purposes, provided such charges are recorded only in memorandum form and do not appear in the fund accounts.

10. The accrual basis of accounting is recommended for Enterprise, Trust, Capital Projects, Special Assessment, and Intragovernmental Service Funds. For the General, Special Revenue, and Debt Service Funds, the modified accrual basis of accounting is defined as that method of accounting in which expenditures other than accrued interest on general long-term debt are recorded at the time liabilities are incurred and revenues are recorded when received in cash, except for material or available revenues which should be accrued to reflect properly the taxes levied and the revenues earned.

11. Government revenues should be classified by fund and source. Expenditures should be classified by fund, function, organization unit, activity, character and principle classes of objects in accordance with standard recognized classifications.

12. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports.

13. Financial statements and reports showing the current condition of budgetary and proprietary accounts should be prepared periodically to control financial operations. At the close of each fiscal year, a comprehensive annual financial report covering all funds and financial operations of the governmental unit should be prepared and published.

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[a]National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago: Municipal Finance Officers Association, 1968), pp. 3-14.

II-F

Accounting Postulates--Maurice Moonitz 1961[a]

Postulate A-1. Quantification. Quantitative data are helpful in making rational economic decisions; i.e., in making choices among alternatives so that actions are correctly related to consequences.

Postulate A-2. Exchange. Most of the goods and services that are produced are distributed through exchange, and are not directly consumed by the producers.

Postulate A-3. Entities (including identification of the entity). Economic activity is carried on through specific units or entities. Any report on the activity must identify clearly the particular unit or entity involved.

Postulate A-4. Time period (including specification of the time period). Economic activity is carried on during specifiable periods of time. Any report on that activity must identify clearly the period of time involved.

Postulate A-5. Unit of measure (including identification of the monetary unit). Money is the common denominator in terms of which the exchangeability of goods and services, including labor, natural resources, and capital, are measured. Any report must clearly indicate which money (e.g., dollars, francs, pounds) is being used.

Postulate B-1. Financial statements. (Related to A-1). The results of the accounting process are expressed in a set of fundamentally related financial statements which articulate with each other and rest upon the same underlying data.

Postulate B-2. Market prices. (Related to A-2). Accounting data are based on prices generated by past, present, or future exchanges which have actually taken place or are expected to.

Postulate B-3. Entities (Related to A-3.) The results of the accounting process are expressed in terms of specific units or entities.

Postulate B-4. Tentativeness. (Related to A-4.) The results of operations for relatively short periods of time are tentative whenever allocations between past, present, and future periods are required.

Postulate C-1. Continuity (including the correlative concept of limited life). In the absence of evidence to the contrary, the entity should be viewed as remaining in operation indefinitely. In the presence of evidence that the entity has a limited life, it should not be viewed as remaining in operation indefinitely.

Postulate C-2. Objectivity. Changes in assets and liabilities, and the related effects (if any) on revenues, expenses, retained earnings, and the like, should not be given formal recognition in the accounts earlier than the point of time at which they can be measured in objective terms.

Postulate C-3. Consistency. The procedures used in accounting for a given entity should be appropriate for the measurement of its position and its activities and should be followed consistently from period to period.

Postulate C-4. Stable unit. Accounting reports should be based on a stable measuring unit.

Postulate C-5. Disclosure. Accounting reports should disclose that which is necessary to make them not misleading.

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[a]Maurice Moonitz, "The Basic Postulates of Accounting," Accounting Research Study No. 1 (New York: American Institute of Certified Public Accountants, 1961), pp. 52-53.

II-G

Accounting Principles--Robert T. Sprouse and Maurice Moonitz 1962[a]

A. Profit is attributable to the whole process of business activity. Any rule or procedure, therefore, which assigns profit to a portion of the whole process should be continuously re-examined to determine the extent to which it introduces bias into the reporting of the amount of profit assigned to specific periods of time.

B. Changes in resources should be classified among the amounts attributable to

1. Changes in the dollar (price-level changes) which lead to restatements of capital but not to revenues or expenses.

2. Changes in replacement costs (above or below the effect of price-level changes) which lead to elements of gain or of loss.

3. Sale or other transfer, or recognition of net realizable value, all of which lead to revenue or gain.

4. Other causes, such as accretion or the discovery of previously unknown natural resources.

C. All assets of the enterprise, whether obtained by investments of owners or of creditors, or by other means, should be recorded in the accounts and reported in the financial statements. The existence of an asset is independent of the means by which it was acquired.

D. The problem of measuring (pricing, valuing) an asset is the problem of measuring the future services, and involves at least three steps:

a. A determination if future services do in fact exist. For example, a building is capable of providing space for manufacturing activity.

b. An estimate of the quantity of services. For example, a building is estimated to be usable for twenty more years, or for half of its estimated total life.

c. The choice of a method or basis or formula for pricing (valuing) the quantity of services arrived at under b, above. In general, the choice of a pricing basis is made from the following three exchange prices:

(1) A past exchange price, e.g., acquisition cost or other initial basis. When this basis is used, profit or loss, if any, on the asset being priced will not be recognized until sale or other transfer out of the business entity.

(2) A current exchange price, e.g., replacement cost. When this basis is used, profit or loss on the asset being priced will be recognized in two stages. The first stage will recognize part of the gain or loss in the period or periods from time of acquisition to time of usage or other dispositions; the second stage will recognize the remainder of the gain or loss at the time of sale or other transfer out of the entity, measured by the difference between sale (transfer) price and replacement cost. This method is still a cost method; an asset priced on this basis is being treated as a cost factor awaiting disposition.

(3) A future exchange price, e.g., anticipated selling price. When this basis is used, profit or loss, if any, has already been recognized in the accounts. Any asset priced on this basis is therefore being treated as though it were a receivable, in that sale or other transfer out of the business (including conversion into cash) will result in no gain or loss, except for any interest (discount) arising from the passage of time.

The proper pricing (valuation) of assets and the allocation of profit to accounting periods are dependent in large part upon estimates of the existence of future benefits, regardless of the bases used to price the assets. The need for estimates is unavoidable and cannot be eliminated by the adoption of any formula as to pricing.

1. All assets in the form of money or claims to money should be shown at their discounted present value or the equivalent. The interest rate to be employed in the discounting process is the market (effective) rate at the date the asset was acquired.

   The discounting process is not necessary in the case of short-term receivables where the force of interest is small. The carrying-value of receivables should be reduced by allowances for uncollectible elements; estimated collection costs should be recorded in the accounts.

   If the claims to money are uncertain as to time or amount of receipt, they should be recorded at their current market value. If the current market value is so uncertain as to be unreliable, these assets should be shown at cost.

2. Inventories which are readily salable at known prices with readily predictable costs of disposal should be recorded at net realizable value, and the related revenue taken up at the same time. Other inventory items should be recorded at their current (replacement) cost, and the related gain or loss separately reported. Accounting for inventories on either basis will result in recording revenues, gains, or losses before they are validated by sale but they are nevertheless components of the net profit (loss) of the period in which they occur.

   Acquisition costs may be used whenever they approximate current (replacement) costs, as would probably be the case when the unit of inventory

components are reasonably stable and turnover is rapid. In all cases the basis of measurement actually employed should be "subject to verification by another competent investigator."

3. All items of plant and equipment in service, or held in stand-by status, should be recorded at cost of acquisition or construction, with appropriate modification for the effect of the changing dollar either in the primary statements or in supplementary statements. In the external reports, plant and equipment should be restated in terms of current replacement costs whenever some significant event occurs, such as a reorganization of the business entity or its merger with another entity or when it becomes a subsidiary of a parent company. Even in the absence of a significant event, the accounts could be restated at periodic intervals, perhaps every five years. The development of satisfactory indexes of construction costs and of machinery and equipment prices would assist materially in making the calculation of replacement costs feasible, practical, and objective.

4. The investment (cost or other basis) in plant and equipment should be amortized over the estimated service life. The basis for adopting a particular method of amortization for a given asset should be its ability to produce an allocation reasonably consistent with the anticipated flow of benefits from the asset.

5. All "intangibles" such as patents, copyrights, research and development, and goodwill should be recorded at cost, with appropriate modification for the effect of the changing dollar either in the primary statements or in supplementary statements. Limited term items should be amortized as expenses over their estimated lives. Unlimited term items should continue to be carried as assets, without amortization.

   If the amount of the investment (cost or other basis) in plant and equipment or in the "intangibles" has been increased or decreased as the result of appraisal or the use of index-numbers, depreciation or other amortization should be based on the changed amount.

E. All liabilities of the enterprise should be recorded in the accounts and reported in the financial statements. Those liabilities which call for settlement in cash should be measured by the present (discounted) value of the future payments or the equivalent. The yield (market, effective) rate of interest at date of incurrence of the liability is the pertinent rate to use in the discounting process and in the amortization of "discount" and "premium." "Discount" and "premium" are technical devices for relating the issue price to the principle amount and should therefore be closely associated with principal amount in financial statements.

F. Those liabilities which call for settlement in goods or services (other than cash) should be measured by their agreed selling price. Profit accrues in these cases as the stipulated services are performed or the goods produced or delivered.

G. In a corporation, stockholders' equity should be classified into invested capital and retained earnings (earned surplus). Invested capital should, in turn, be classified according to source, that is, according to the underlying nature of the transactions giving rise to invested capital.

Retailed earnings should include the cumulative amount of net profits and net losses, less dividend declarations, and less amounts transferred to invested capital.

In an unincorporated business, the same plan may be followed, but the acceptable alternative is more widely followed of reporting the total interest of each owner or group of owners at the balance sheet date.

H. A statement of the results of operations should reveal the components of profit in sufficient detail to permit comparisons and interpretations to be made. To this end, the data should be classified at least into revenue, expenses, gains, and losses.

1. In general, the revenue of an enterprise during an accounting period represents a measurement of the exchange value of the products (goods and services) of that enterprise during that period. The preceding discussion, under D(2), is also pertinent here.

2. Broadly speaking, expenses measure the costs of the amount of revenue recognized. They may be directly associated with revenue-producing transactions themselves (e.g., so-called "product costs") or with the accounting period in which the revenues appear (e.g., so-called "period costs").

3. Gains include such items as the results of holding inventories through a price rise, the sale of assets (other than stock-in-trade) at more than book value, and the settlement of liabilities at less than book value. Losses include items such as the results of holding inventories through a price decline, the sale of assets (other than stock-in-trade) at less than book value or their retirement, the settlement of liabilities at more than book value, and the imposition of liabilities through a lawsuit.

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[a]Robert T. Sprouse and Maurice Moonitz, "A Tentative Set of Broad Accounting Principles for Business Enterprises," Accounting Research Study No. 3 (New York: American Institute of Certified Public Accountants, 1962), pp. 56-59.

II-H

Accounting Concepts--Paul Grady 1965[a]

1. A society and government structure honoring private property rights.
. . . our form of accounting and reporting clearly has no application in totalitarian countries . . . This concept necessarily carries with it not only the honoring of private property rights but the legal means of protecting and inferring them, so long as their use does not interfere with the rights of others or with the public interest.

2. Specific business entities.
The separation of ownership from management of the business entity is a primary factor in imposing on the entity the fiduciary accountabilities of its stockholders. The summary of generally accepted principles later set forth is classified in relation to these fiduciary accountabilities . . . It is automatic that the reporting entity should be clearly identified in financial statements.

3. Going concern.
A large part of accounting practice as well as theory is based on the presumption that the accounting entity will continue in operation and not be liquidated in the forseeable future . . . in the presence of evidence that the entity has a limited life, it should not be viewed as remaining in operation indefinitely.

4. Monetary expression in accounts.
Transactions of business entities are reflected in the accounts in terms of the monetary unit at the time of transaction . . . accounts reflect the price aggregates or costs at the various dates at which transactions are consumated.

5. Consistency between periods for the same entity.
Not precluding desirable changes in accounting practices, but when a significant change is made that fact is required to be disclosed, including the dollar effect upon the financial statements.

6. Diversity in accounting among independent entities.
Diversity in accounting among independent business entities is a basic fact of life . . . It is axiomatic that where there is diffusion in decision making . . . there is bound to be diversity in the accounting results . . . no single manual of construction would fit the needs of all industry.

7. Conservatism.
A quality of judgment to be exercised in evaluating the uncertainties and risks present in a business entity to assure that reasonable provisions are made for potential losses in the realization of recorded assets and in the settlement of actual and contingent liabilities.

8. Dependability of data through internal control.
Dependability of all accounting data including purchase and sales invoices, is obtained through appropriate measures of internal control.

9. Materiality.
A statement, fact, or item is material, if given full consideration to the surrounding circumstances, as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to "make a difference" in the judgment and conduct of a reasonable person.

10. Timeliness in financial reporting requires estimates.
Transactions do not neatly fit the monthly, quarterly and annual periods for which financial reports must be rendered. Such reports must be timely to have any usefulness . . . in many unresolved situations allocations and provisions must be made on the basis of estimates and opinions.

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[a]Paul Grady, "Inventory of Generally Accepted Accounting Principles for Business Enterprises," Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965), pp. 23-45.

II-I

Accounting Principles--Paul Grady 1965[a]

Objective A. Account for sales, revenues, income, cost of sales, expenses, gains and losses in such manner as to present fairly the results of operations for the period or periods of time covered.

Principle A-1. Sales, revenues, and income should not be anticipated or materially overstated or understated. Accordingly, there must be proper cutoff accounting at the beginning and end of the period or periods.

Principle A-2. Costs of sales and expenses should be appropriately matched against the periodic sales and revenues. It follows that there must be proper cutoff accounting for inventories and liabilities for costs and expenses at the beginning and end of the period or periods.

Principle A-3. Appropriate charges should be made for depreciation and depletion of fixed assets and for amortization of other deferred costs.

Principle A-4. Proper distribution of costs should be made as between fixed assets, inventories, maintenance and expense. Direct costs are usually identifiable and common costs applicable to more than one activity should be distributed on appropriate cost incurrence bases such as time or use factors.

Principle A-5. Contingency provisions and reserves should not be misused as a means of arbitrarily reducing income or shifting income from one period to another.

Principle A-6. Nonrecurring and extraordinary gains and losses should be recognized in the period they occur, but should be shown separately from the ordinary and usual operations.

Principle A-7. There is a strong presumption that all gains and losses will be included in periodic income statements unless they are of such magnitude in relation to revenues and expenses from regular operations as to cause the statements to be misleading.

Principle A-8. Disclose rental charges under material leases and capitalize those which are in effect installment purchases of fixed assets.

Principle A-9. If accounting principles in the determination of periodic results have not been consistently maintained, the effect of the change should be stated.

Objective B. Account for the equity capital invested by stockholders through contribution of assets or retained earnings in a meaningful manner on a cumulative basis and as to changes during the period or

periods covered. The account structure and presentation in financial statements of a business entity are designed to meet statutory and corporate charter requirements and to portray significant financial relationships.

Principle B-1. In case there are two or more classes of stock, account for the equity capital invested for each and disclose the rights and preferences to dividends and to principal in liquidation.

Principle B-2. From a financial viewpoint the capital invested by stockholders is the corpus of the enterprise and its identity should be fully maintained. Any impairment of invested capital resulting from operating deficits, losses of any nature, dividend distributions in excess of earnings, and treasury stock purchase is accounted for both currently and cumulatively.

Principle B-3. Capital surplus, however created, should not be used to relieve the income account of the current or future years of charges which would otherwise fail to be made thereagainst. There should be no commingling of retained earnings with invested capital in excess of par or stated values.

Principle B-4. Retained earnings should represent the cumulative balance of periodic earnings, less dividend distributions in cash, property or stock, plus or minus gains and losses of such magnitude as not to be properly included in periodic earnings. The entire amount may be presumed to be unrestricted as to dividend distributions unless restrictions are indicated in the financial statements.

Principle B-5. Retained earnings may be decreased by transfers to invested capital accounts when formal corporate action has, in fact, changed the composition of the equity capital. Accumulated deficit accounts may be eliminated against invested capital accounts through formal action approved by stockholders, which establishes a new base line of accountability.

Principle B-6. The amount of any revaluation credits should be separately classified in the stockholder's equity section, and it is not available for any type of charge except on reversal of the revaluation.

Principle B-7. Disclose status of stock options to employees or others and changes therein during the period or periods covered.

Objective C. Account for the assets invested in the enterprise by stockholders (through property contributed or retained earnings) and creditors, in a meaningful manner, so that when considered with the liabilities and equity capital of stockholders there will be a fair presentation of the financial position of the enterprise both at the beginning and end of the period. It should be understood that financial position or balance sheet statements do not purport to show either present values of assets to the enterprise or values which might be realized in liquidation.

Principle C-1. Items classified as current assets should be carried at not more than is reasonably expected to be realized within one year or within the normal operating cycle of the particular business. Cash should be segregated between unrestricted and restricted items, and the inclusion of the latter in current assets must be justified by their nature. Receivables should be reduced by allowance accounts to cover expected collection of other losses. Receivables from officers, employees, or affiliated companies should be shown separately. Inventories should be carried at cost or market, whichever the lower. Cost comprises direct costs plus factory overhead costs, and the basis of determination (e.g., Lifo, Fifo or average) should be stated. Prepaid items should be properly chargeable to future periods.

Principle C-2. Fixed assets should be carried at cost of acquisition or construction in the historical accounts, unless such cost is no longer meaningful. Cost of land should ordinarily be shown separately. Cost of construction includes direct costs and overhead costs incurred, such as engineering, supervision and administration, interest and taxes. Items treated as fixed assets should have at least one year of expected useful life to the enterprise, and normally the life is considerably longer. Practicable yardsticks or criteria should be established in order that consistent distinctions may be made between fixed assets, operating expenses and maintenance. Ordinarily, this should be accomplished by creating a catalogue of property units to be included in fixed assets, any lesser items to be charged to current expense. Items no longer in service should be removed by charge to depreciation reserve or expense in order that fixed assets will represent the cost of properties in service.

Principle C-3. Appropriate provision or allowances should be made in order to charge operations with the investment in depreciable assets over the estimated life thereof. The accumulated allowances, less property retirements, should be shown as a deduction from fixed assets.

Principle C-4. Long-term investments in securities ordinarily should be carried at cost. When market quotations are available, the aggregate quoted amounts should be disclosed. Investments in affiliates should be segregated from other investments.

Principle C-5. The costs of intangible items, such as debt discount and expense, patents, copyrights, research and development (if deferred) and goodwill should be shown separately. Limited-term items should be amortized against earnings over their estimated lives. The policy in regard to amortization of unlimited-term intangibles should be disclosed.

Principle C-6. The nature and extent of hypothecated or pledged assets should be shown.

Objective D. Account for all known liabilities in a meaningful manner in order that their summarization, considered together with the statement

of assets and equity invested by stockholders, will fairly present the financial position of the enterprise at the beginning and end of the period.

Principle D-1. All known liabilities should be recorded regardless of whether the definite amount is determinable. If the amounts cannot be reasonably approximated, the nature of the items should be disclosed on the fact of the summary of liabilities or by footnote.

Principle D-2. Current liabilities should include items payable within one year or at the end of the operating business cycle used in the classification of current assets. Accounts should be shown separately for notes payable to banks, notes payable to others, accounts payable (may include payrolls), Federal income taxes accure, other accrued taxes, accounts or notes payable to officers, and accounts or notes payable to affiliates.

Principle D-3. Long-term liabilities should be described and due dates and rates of interest shown.

Principle D-4. The nature and extent to which specific liabilities are a preferred lien on assets should be shown.

Principle D-5. Deferred income should be separately classified and described.

Principle D-6. Contingent liabilities of importance should be disclosed.

Objective E. Financial statements should comply with the applicable reporting standards included in generally accepted auditing standards. Reporting to investors should be performed on an entity basis.

Principle E-1. Generally accepted reporting standards applicable to financial statements are set forth in Chapters 7, 8, 9 and 11 of Statements on Auditing Procedure No. 33, which are incorporated in this Inventory.

Principle E-2. Where there is a parent company and one or more subsidiaries, there is a presumption that consolidated statements are more meaningful than separate statements.

Principle E-3. The accounts of consolidated subsidiaries or divisions operating in foreign countries should be translated into dollars at the appropriate rates of exchange.

Principle E-4. Where two or more previously independent entities merge or otherwise combine in such a manner as to constitute a pooling of interests, the new entity inherits the bases of accountability of the constituent entities.

Principle E-1 states that the standards for financial statements as set forth in chapter 7, 8, 9 and 11 of Statements on Auditing Procedure

No. 33 are incorporated in the Inventory. These include the following primary principles:

> The reports shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
>
> The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
>
> Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
>
> The report shall either contain an expression of an opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

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[a]Paul Grady, "Inventory of Generally Accepted Accounting Principles for Business Enterprises," Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965), pp. 57-68.

STUDY OF LOCAL GOVERNMENT FINANCIAL REPORTING IN GEORGIA

APPENDIX III

III-A

Local Government Agencies in Richmond County Included in Study

I. Personal Safety

A. Law Enforcement

1. City of Augusta Police Department
2. Richmond County Sheriff
3. Coroner
4. City Stockade
5. Richmond County Jail
6. Richmond County Prison
7. Richmond County Physician
8. Local court system

B. Fire Prevention and Control

1. City of Augusta Fire Department
2. Georgia Forestry Commission (multi-county)

C. Safety from Animals

1. City of Augusta Animal Control Commission

D. Protection from and Control of Natural and Man-made Disasters

1. Augusta-Richmond County Civil Defense Department

II. Health

1. Richmond County Board of Health
2. Richmond County Hospital Authority

III. Intellectual Development and Personal Enrichment

1. Richmond County Board of Education
2. Augusta-Richmond County Public Library

IV. Satisfactory Home and Community Environment

A. Planning, Housing, and Renewal

1. Augusta-Richmond County Planning Commission
2. Augusta Housing Authority
3. City of Augusta Department of Urban Renewal
4. Augusta-Richmond County Building Authority

B. Enforcement of Zoning and Other Environmental Codes

1. City of Augusta Building Inspection Department

2. Richmond County Inspection Department
3. City of Augusta Department
4. Richmond County License and Enforcement Bureau
5. Augusta-Richmond County Board of Zoning Appeals

C. Cemeteries

1. Magnolia and Cedar Grove Cemeteries
2. West View Cemetery

V. Economic Satisfaction and Satisfactory Work Opportunities for the Individual

A. Agencies Seeking to Stimulate Commerce

1. Richmond County Extension--County Agricultural Agent
2. Georgia Forestry Commission (Richmond, Columbia, McDuffie, Warren Area)

B. Local Contribution to the State Welfare Program

1. Richmond County Department of Family and Children's Services

VI. Satisfactory Leisure-Time Opportunities

1. City of Augusta Recreation Department
2. Richmond County Recreation Department
3. City of Augusta Golf Course
4. Municipal Auditorium
5. City of Augusta Trees and Parks Department

VII. Transportation

A. Mass Transportation

1. Augusta Port Authority
2. Aviation Commission--City of Augusta

B. Individual Transportation

1. Electrical--Street Lighting and Traffic--City of Augusta
2. Parking Meters Department--City of Augusta
3. Traffic Engineer (Joint)
4. Richmond County Engineering Department
5. City of Augusta Streets and Drains Department

VIII. General Administration and Support

A. Service to Property

1. Engineering Department (City)
2. Streets and Drains (City)

3. Richmond County Water and Sewer System
4. Waterworks Office and Sales (City)
5. Augusta Canal and Waterworks (Construction)
6. Sanitary Department (City)
7. Richmond County Sanitation (Private Collectors)
8. Richmond County Landfill

B. Budgeting and Financial

1. Collection of Revenues Department (City)
2. City Comptroller
3. Richmond County Tax Commission
4. Treasurer of Richmond County
5. Augusta-Richmond County Tax Assessing Office
6. City Sheriff

C. Staff Services

1. Civil Service Commission (City)
2. Department of Personnel (City)
3. City Attorney
4. Attorney for Board of Commissioners of Richmond County
5. Data Processing Department (City)
6. Clerk of County Commission and Purchasing Office
7. Clerk/Purchasing Agent (City)
8. Central Automotive Maintenance Shop (City)
9. Richmond County Board of Registrars

III-B

Richmond County Agency Data Utilized in Study

SAMPLE

Person Interviewed _____

Date Interviewed _____

Agency Designation

Title _____

City ____ County ____ Other ____

Legal Basis of Agency:

_____

Method of Selecting Director:

Appointed _____

Elected _____

Agency Powers and Authorities:

_____

Agency Functions:

_____

Procedure for Preparing Agency Budget:

_____

Type of Cost Data Available:

_____

Other Agencies Dealt With:

_____

Revenue and Expenditure Pattern Details:

_____

Financial Reporting Details: (attach copy of latest report)

III-C

Richmond County Area Financial Growth of Local Governments

Revenue Sources
All Local Governments within Richmond County
(Nos. in 1,000s)

	1956	1961	1966
Intergovern. State	$ 2,596	$ 5,054	$ 9,494
Intergovern. Other	438	874	2,547
Property Tax	6,015	7,803	12,015
Other Tax	1,010	1,144	1,392
Charges and Misc.	2,138	6,967	11,352
Utility Revenue	1,114	1,607	2,622
Total	$13,311	$23,449	$39,422

Source: U. S. Census of Governments

Table

Richmond County Area Financial Growth of Local Governments

Direct General Expenditures
All Local Governments
Augusta-Richmond County Area
Selected Years
(Nos. in 1,000s)

		1956	1961	1966
I.	Personal Safety	$ 1,466	$ 1,708	$ 2,286
II.	Health	2,669	4,359	7,275
III.	Intellectual Development and Personal Enrichment	5,160	8,326	13,864
IV.	Satisfactory Home and Community Environment	--	1,095	6,648
V.	Economic Satisfaction and Satisfactory Work Opportunities	121	178	341
VI.	Satisfactory Leisure Time	244	331	393
VII.	Transportation - Communication	925	1,240	2,097
VIII.	General Administration & Support	2,163	3,039	5,443
IX.	Other	2,008	1,072	1,291
	Total	$14,756	$21,348	$39,638

Source: U. S. Census of Governments

III-E

Georgia Local Governments Included in Survey of Financial Reporting

Cities

Abbeville
Albany
Atlanta
Ashburn
Barnesville
Blackshear
Brunswick
Buena Vista
Cartersville
Centerville
Cleveland
College Park
Covington
Dawson
Decatur
Doraville
Dublin
Eastman
Eatonton
Elberton
Fayetteville
Gainesville
Glenville
Greensboro
Jefferson
Kennesaw
Lafayette
LaGrange
Madison
Marietta
Meigs
Montezuma
Monticello
Moultrie
Newnan
Pelham
Perry
Pine Lake
Reynolds
Richland
Roswell
Sandersville
Savannah
Symrna
Sparta
Sugar Hill
Sylvester
Union City
Vienna
Warner Robins

Counties

Bacon
Banks
Barrow
Bartow
Ben Hill
Bryan
Butts
Calhoun
Carroll
Catoosa
Clayton
Cobb
Colquitt
Crawford
Crisp
Dawson
Dodge
Dougherty
Echols
Floyd
Franklin
Fulton
Glascock
Glynn
Hall
Hart
Henry
Houston
Jasper
Long
Lumpkin
Madison
McDuffie
Mitchell
Monroe
Montgomery
Muscogee
Polk
Rockdale
Stewart
Tatnall
Thomas
Troup
Twiggs
Walker
Walton
Washington
Webster
Whitfield
Wilkes
Worth

Population Size Grouping of Georgia Cities and Counties in Sample*

Population Size Group	Number	Sample
Over 100,000	11	5
50,000 to 99,999	13	9
25,000 to 49,999	25	10
10,000 to 24,999	84	26
Less than 10,000	595	50

*This compilation based on preliminary 1970 census figures. Of the units less than 10,000 population, 434 are cities of less than 2,500 for which in most cases no financial report is prepared. Although making up most of the units in numbers these cities contain less than seven percent of the state's population and many exist in name only.

III-F

Data Model for Analysis of Financial Statements

A. Name - city or county
Date - period covered by the audit
Population - 1970 population of units
Manager - does the unit have a manager
From - name of auditing firm
Certified-Public - were auditors CPAs or public accountants

B. See attached list of questions to be answered yes, no, or not applicable.

C. 1. Will be checked if the financial report includes the particular fund.

2. Will be checked if the financial statement is included:

a. Fund Balance Sheet
b. Statement (X) of Revenue and Expenditure
c. Statement of Changes in Fund Balance

3. Basis - of accounting; is fund kept on a cash, accrual for modified accrual basis?

4. Dp - Depreciation is it recorded on this fund?

5. Bgt - Are budgeted revenues and expenditures shown?

D. Does the financial report include combined statements? The NCGA recommends five combined statements and two combined schedules. The number circled would mean it was included.

E. Does the financial report include statistical tables. The NCGA recommends seventeen tables. The number circled would mean it was included.

F. Is the financial report properly organized as a communication vehicle?

1. Letter of Transmittal good form.
2. Table of Contents and properly indexed.
3. Names of chief officials.
4. Footnotes.
5. Certificate of Conformance.

G. Timing - how long after the close of the fiscal period was the audit report completed?

Data Checklist for Financial Reports Included in Survey

Counties	
Audits prepared by Certified Public Accountants	45
Audits prepared by Public Accountants	5
Cities	
Audits prepared by Certified Public Accountants	45
Audits prepared by Public Accountants	5
Number of different firms	80
Timing of Audit Report	
No Date	6
Within 30 days of end of fiscal period	13
Within 30 to 60 days of the end of the fiscal period	32
Within 60 to 90 days of the end of the fiscal period	17
Over 90 days from the end of the fiscal period	32
Use of Comparative Figures	
Compared Current Period Actual with Prior Period Actual	20
Compared Current Period Actual with Budgeted Figures	12
Compared Current Period Actual with Budgeted and Prior Period Actual	5
Recording Depreciation in Accounts	
On Enterprise Funds Only	19
On All Funds	7
Reported But Not Recorded in Accounts	1

Data Checklist (continued)

Combined Financial Statements

Financial Report Includes all Combined Statements		4
Financial Reports Including No Combined Statements		61
Financial Report Included the Following:		
Balance Sheet	33	
Receipts and Expenditures	9	
Receivables	1	
Investments	2	
Surplus	2	
Financial Report Includes One or More Combined Statement		39

Fund Structure

One Fund		
All Statements Included	10	
One Statement Missing	9	
Two Statements Missing	1	20
Two Funds		
All Statements Included	3	
One Statement Missing	3	
Two Statements Missing	11	17
Three or More Funds		
All Statements Included	15	
One Statement Missing	1	
Two Statements Missing	36	52
Not Reported on a Fund Basis		11
		100

Was the Financial Report Properly Organized	
Yes	36
No	64

Statistical Tables Included in Financial Reports

Adequate Use of Statistical Tables	6

Statistics Reported:

Debt	Payables
Insurance	Surety Bonds
Tax Digest	Investments
Fines	Pensions

Checklist of Questions on Financial Reports Included in Survey

		Yes	No
1.	Did the auditor prepare the financial statements?	96	4
2.	Does the auditor state that he has examined the financial statement (appropriately identified) rather than "books and records" or similar vague references?	48	52
3.	Does the auditor's report clearly indicate which funds or offices have been included and those that were excluded in the examination?	63	37
4.	Does the auditor represent that his examination was made in accordance with generally accepted auditing standards?	67	33
5.	Has the auditor stated that he has performed all audit procedures considered necessary in the circumstances without exception?	46	64
6.	Has the auditor made a representation as to conformance with generally accepted accounting principles?	41	59
7.	Has the auditor made reference to consistency of application of accounting principles or clearly expressed his exception thereto?	44	56
8.	Does the auditor express an unqualified opinion on the financial statement?	29	71
9.	If an unqualified opinion has not been expressed by the auditor, has he clearly indicated the reasons for a denial of opinion, of his exceptions to an unqualified opinion?	37	63
10.	Do the statements on the auditor's report indicate that there is any existing conflict with current legal requirements of the organization and generally accepted accounting principles?	98	2
11.	Is the period of time covered by the financial statements adequately identified?	100	0
12.	Is the terminology utilized in the financial statements consistent with that recommended by the National Committee on Governmental Accounting?	20	80

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BIOGRAPHICAL SKETCH

Donald Royal Law was born August 23, 1930, at West Pittston, Pennsylvania. In June, 1948, he was graduated from West Pittston High School. In June, 1952, he received the degree of Bachelor of Science with a major in accounting from Wilkes College. From 1952 until 1954 he served in the United States Army. Following his discharge from the army, he worked for General Electric Co. until 1960. From 1960 until 1962 he worked for the Martin Marietta Co. and from 1962 until 1964 he worked for Honeywell Corporation. In 1964 he enrolled in the Graduate School of the University of Florida. He received the degree of Master of Arts with a major in Accounting in 1965. From September, 1965, until the present time he has pursued his work toward the degree of Doctor of Philosophy. Since June, 1968, he has been an Assistant Professor in the Accounting Department and the Institute of Government of the University of Georgia.

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Doctor of Philosophy.

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I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Doctor of Philosophy.

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